



# Deloitte<sup>i</sup> US LIBOR Transition Newsletter

A summary of US regulatory and market updates related to the transition from LIBOR

[Executive Summary](#)

[Regulatory Updates](#)

[Global Highlights](#)

[Our Perspective](#)

[Market Updates](#)



## Executive Summary

The Office of the Comptroller of the Currency's (OCC) Director Joseph Otting announced that they will begin discussions with private banks around establishing an alternative to LIBOR that could be suitable for loans. Regional banks and other industry participants have voiced their concerns that SOFR, as it stands, does not have a credit component so it may not be as sensitive in periods in stress. The OCC has taken it onto their own hands to consider alternatives.

The Alternative Reference Rate Committee (ARRC) released a buy-side checklist detailing steps for an effective shift to SOFR adoption and a survey to assist software and technology vendors assess readiness their SOFR readiness. The checklist is designed to be used alongside the "User's Guide to SOFR" intended for buy-side firms and the survey acts as a platform for vendors to raise operational issues to the ARRC.

On January 23, 2020 the New York Department of Financial Services (NY DFS) announced that the deadline for NY regulated firms to submit their plans for managing the risks relating the LIBOR transition has been extended from February 7, 2020 to March 23, 2020. The ARRC also released the consultation on "Potential Spread Adjustment Methodologies" for public comment. The consultation outlines the proposed methodologies to calculate the static spread between Secured Overnight Financing Rate (SOFR) and LIBOR such as if the mean or median should be used, the required length of the historic data to calculate the mean or median and if there should be a transition period.



## Our Perspective

### **Looking for an Alternative Reference Rate**

The OCC's comments to begin discussion to find an alternative to LIBOR came as a surprise, as it strayed away from the ARRC's already recommended SOFR. The group will likely begin discussing the benefits and challenges that surround credit sensitive rates such as AMERIBOR or the Bank Yield Index. Each have their own concerns such as if there is enough trade volume and that they are not yet accepted for hedge accounting. Although the credit sensitive component is important to market participants, especially for cash products, it may be challenging to generate such a rate due to the current market conditions. We encourage firms to continue to plan accordingly for the transition to SOFR as various market participants may still want to leverage SOFR even if a credit sensitive rate is available.

### **Clarity for Asset Managers and a Step Towards Vendor Readiness Plans**

The ARRC releasing a buy-side checklist marks an important milestone for asset managers and owners in identifying risks and mitigation plans. The similar checklist that was previously released for Banks has helped banking institutions develop a broad transition roadmap to SOFR and allowed insight into the important risk considerations for each area of their program. Buy-side firms may now have a similar degree of clarity and expectations. ARRC also releasing the survey to assess vendors readiness plans for SOFR can help market participants gain clarity around their external dependencies. It is important for market participants to closely monitor the results of the survey and adjust their internal LIBOR transition roadmap timelines accordingly.

### **Spread Adjustment Methodology Considerations**

The spread adjustment methodology consultation from the ARRC outlines the methodologies ARRC are thinking of developing a spread adjustment. When considering the consultation, firms may want to review the ISDA summary of responses to the ISDA consultation on spread and term adjustments. Considering the implications of the spread adjustment to the various cash products and the derivatives for hedging, systems requirements, and overall consistency may be important when responding to the consultation.



## Regulatory Updates

### US Regulatory Highlights

- The OCC Director Joseph Otting announced that federal banking agencies are planning to launch a dialogue with private banks around establishing an alternative to LIBOR that could be suitable for loans. The article is available [here](#).
- ARRC released a buy-side checklist detailing steps for an effective shift to SOFR adoption. The checklist is available [here](#).
- ARRC released a survey to assist software and technology vendors assess readiness their SOFR readiness. The survey is available [here](#).
- On January 23, 2020, NY DFS announced that the deadline for regulated entities to submit their LIBOR transition plans has been extended from February 7, 2020 to March 23, 2020. The letter is available [here](#).
- ARRC has finalized and published its consultation for potential spread adjustment methodologies. The consultation is available [here](#).

### Summary of ARRC Office Hours Q&A with David Bowman (The Federal Reserve Board (FRB))

This section represents a summary of the ARRC office hours Q&A with David Bowman from December 4, 2019, until December 31, 2019. Weekly office hour information can be found [here](#). The information below does not represent the view of the Federal Reserve but represents the personal views of David Bowman outside of his official capacity. Below are some of the specific topics discussed:

#### *Updates Regarding New York State (NYS) Legislative Relief*

- NYS has agreed to begin discussions concerning possible legislative relief. "Attachment 1" in the November minutes present the proposed approaches (The minutes is available [here](#)). The proposal outlines what is included in the fallback language and could apply to agreements without fallback languages or those that fall back to a LIBOR-like rate (e.g., polling of banks). Floating rate notes (FRNs) and securitizations may be difficult to amend due to the 100% consent rule in NYS. If, however, the security has the ability for amendment by the discretion of one administrator, a safe harbor for transition is provided. The ARRC's proposal do not apply, however, to contracts with fallback language which falls back to another floating rate.

#### *Two Methods for Compounding*

- There have been two candidates on how to calculate compound interest: 1) compounding the rate, or 2) compounding the balance. When used appropriately, both methods of calculating compound interest will result in the same amount – the ISDA formula will work with both calculation methods.

#### *Spread Consultation Term Rate and Long-Run Tenors*

- The term rate used in the appendix of the spread consultation is a 12 months term rate. It compares one-year LIBOR to a one-year term Overnight Index Swap (OIS) (The consultation is available [here](#)). In the event a trigger event is reached and only compound average SOFR is available at the time, the consultation describes spread adjustment methodologies for both term SOFR and compound SOFR in arrears and in advance.

#### *Dynamic Credit Spread for SOFR*

- It is unlikely the dynamic credit spread could be generated based on available data. The underlying market does not have many transactions and each bank has different rates. The Bank Yield Index is a proposed rate that has a credit component, but there are some issues with the rate, namely not being forward-looking. The ARRC has also released the spread adjustment consultation which includes a section providing the reasoning behind the recommendation for a static spread (The consultation is available [here](#)).

#### *Defined Timeline for LIBOR to SOFR Transition*

- There is no current defined target date for the transition from LIBOR to SOFR. However, UK regulators have laid out goals for the Sterling Transition as the Sterling Overnight Interbank Average Rate (SONIA) has a longer history of publication. The ARRC is reviewing the Sterling goals and are discussing if they can outline expectations for certain product types for this year.

#### *Tax, Accounting or Margin Status*

- The Treasury's proposal, as well as the Financial Accounting Standards Board (FASB)'s impending accounting changes, Commodity Futures Trading Commission (CFTC) no action relief letter, and various proposals from other regulators on margin relief, are helpful to reassure participants worried about tax, accounting, or margin status. These concerns were at times the last impediments to the LIBOR position. It is important to remember, however, that these are advisory decisions on tax implications, and are not legislative actions.

#### *Lookbacks with Observation Shifts*

- When applying an Observation Shift to a lookback, the weight of the look back date is applied to look back rate. The Observation Shift will correspond exactly to what you may see in the OIS market conventions. Without the Observation Shift, however, the current day's weight could instead be applied to the lookback rate and will result in some basis. This is described in the appendix to "SOFR Floating Rate Notes Conventions" Matrix. The appendix is available [here](#).

#### **ARRC Working Group**

- ARRC has published recommendations for Interdealer Cross-Currency Swap market Conventions. The recommendations are available [here](#).
- A potential NYS legislative solution for legacy USD LIBOR cash products may raise constitutional issues. The article is available [here](#).
- Diagram of ARRC benchmark replacement waterfalls. The image is available [here](#).

#### **ISDA Updates**

- ISDA has published its review for Interest Rate Benchmarks for 2019. The review is available [here](#).
- ISDA has published an article on pre-cessation issues. The article is available [here](#). The FCA wrote a letter to ISDA. The letter is available [here](#). Similarly, the Intercontinental Exchange (ICE) Benchmark Administration (IBA) published a letter to ISDA, The letter is available [here](#).
- A summary of the full year 2019 ISDA SwapsInfo was published. The article is available [here](#).
- ISDA published a supplemental consultation on spread and term adjustments, including final parameters for fallbacks in derivatives referencing EUR LIBOR, EUR Interbank Offer Rate (EURIBOR) as well as other less widely used IBORs. The consultation is available [here](#).
- ISDA posted a summary of important issues (including Benchmarks) for 2020 available. The article is available available [here](#).

#### **Other News / Useful Reading**

- RiskNet published an article considering further consultations on pre-cessation issues and triggers. The article is available [here](#).
- Bloomberg has released an article on LIBOR transition. The article is available [here](#).
- The Chicago Mercantile Exchange (CME Group) published a 2019 SOFR "Ecosystem" recap. The article is available [here](#).
- The Financial Stability Board (FSB) annual progress report sets out the need to reduce risks to financial stability from LIBOR transition. The report is available [here](#).
- IBA published a consultation on input data for the ICE Swap Rate. The consultation is available [here](#).
- Banks warned of PPI-style compensations claims in LIBOR transition. The article available [here](#).
- Financial Industry Regulatory Authority (FINRA) news blog article: "Conversations About LIBOR: Discussing the Past, Present and Future of the World's Most Important Number." The article is available [here](#).
- Moody's research announcement that Post-Libor reference rates are less volatile under stressed scenarios. The report is available [here](#).
- Analysis on practical risk free rate (RFR) implementation and themes for 2020. The report is available [here](#).
- Calm in the money markets over the new year will not silence growing calls for the FRB to provide a standing repo facility. The article is available [here](#).



**Increase in Debt Issuance Referenced to SOFR**

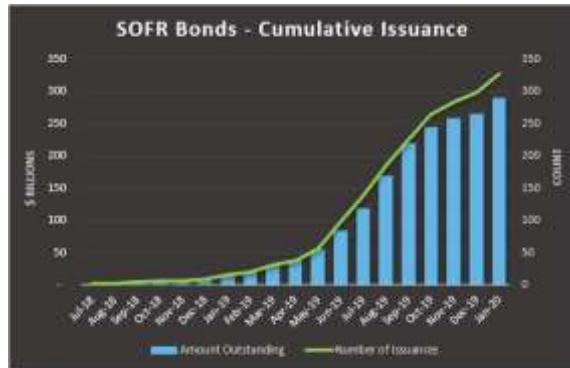
The issuance of floating-rate debt linked to SOFR saw an uptick in the month of January 2020 compared to the declining trend observed in the prior months of November and December 2019. The issuance increased to \$24.8 billion in the month of January 2020 which has gone up from \$6.5 billion in December 2019 and \$13.9 billion in November 2019. The graphs below represent data through December 31, 2019.

The cumulative issue size of SOFR bonds outstanding currently stands at \$291.4.3 billion with 331 bonds (this excludes the matured bonds) through January 31, 2020. There were 28 new issuances in the month of January compared to 16 and 18 issuances in December and November respectively.

In the month of January 2020, federal agencies issued SOFR referenced float rate notes worth \$2.35 billion and there were 16 other institutions which contributed \$22.5 billion to the outstanding amount of SOFR referenced debt.



Source: Bloomberg, compiled by Deloitte  
\*Data as of Jan 31, 2020

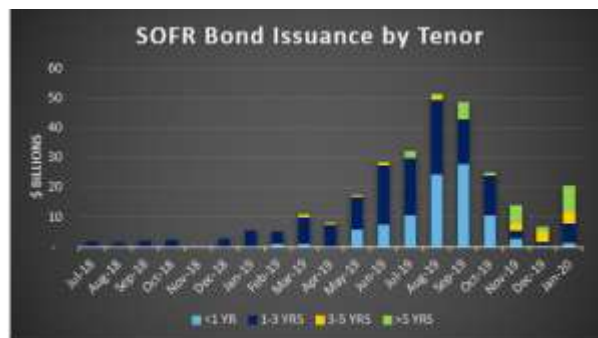


Source: Bloomberg, compiled by Deloitte  
\*Data as of Jan 31, 2020

**Increase in Longer Dated Debt Issuance Referenced to SOFR**

Majority of the SOFR bonds issued have a maturity of less than five years. During the month of January 2020, bonds worth \$12.2 billion, which have a maturity greater than or equal to three years, were issued. It is a new monthly high for the issuances with a tenor greater than or equal to 3 years. This comprises of 4 bonds worth \$7.8 billion which have a maturity greater than or equal to ten years.

There were 39 issuances worth \$24.2 billion, with a maturity greater than or equal to five years, through January 31, 2020. Included in this are 29 issuances worth \$15.4 billion with a term greater than or equal to 10 years.



Source: Bloomberg, compiled by Deloitte  
\*Data as of Jan 31, 2020

## Cumulative SOFR Interest Rate Derivatives

### SOFR Swaps

- SOFR swaps continued their momentum in 2020; the notional volume of SOFR-based interest rate and basis swaps totaled \$72.0 billion through January 31, 2020.
- At the end of January 2020, the notional volume of SOFR-based interest rate and basis swaps totaled \$72.0 billion compared to the \$45.0 billion in December 2019, and \$65.8 billion in November 2019.



Source: <http://swapsinfo.org>, compiled by Deloitte  
 \*Data as of Jan 31, 2020

### SOFR Futures

- As per the data available on CME, for the month of January 2020, SOFR futures volume exceeded 40K contracts/day with more than 375 global participants. The article is available [here](#). There is an increase of ~17% in the average daily volume compared to the month of December 2019.
- The month-end open interest decreased by ~22% for the month of January 2020 compared to December 2019.



Source: CME Group  
 \*Data as of Jan 31, 2020



## Global Highlights

### United Kingdom

- Sterling debt issuers are calling on authorities to formally back a compounded-in-arrears index for the SONIA. The article is available [here](#).
- Nationwide Building Society issued the first sterling covered SONIA-linked bond of the year on January 3, 2020. The article is available [here](#).
- Lloyds is aiming to future-proof £4bn of LIBOR fixed rate covered bonds to SONIA. The article is available [here](#).
- UK regulators launch fresh push to switch away from Libor. The article is available [here](#).
- Judgement day looms for dealers in swap shift to SONIA. The article available [here](#).
- Deadline to end use of GBP LIBOR-linked loans in Q3 in doubt as banks stall on software changes. The article is available [here](#).
- London Clearing House (LCH) records double-digit growth for interest rate derivatives business. The article is available [here](#).

### European Union

- The Swedish Financial Benchmark Facility (SFBF) will take over the calculation and administration of the Stockholm Interbank Offered Rate (STIBOR) on April 20, 2020. The article is available [here](#).
- The European Central Bank (ECB) released an FAQ for the transition to EuroSTR. The FAQ is available [here](#).
- ECB released a checklist to assist with the EONIA transition to EuroSTR. The checklist is available [here](#).
- Potential legal issues with RFR and compounding interest in the EU and loan system update issues. The article is available [here](#).

### Asia

- A recent survey in Japan indicated that the majority of market participants had a preference for forward-looking term rates instead of compounded risk-free rates as a reference for new loans and floating rate notes. The article is available [here](#).
- Asia Securities Industry & Financial Markets Association (ASIFMA) held their webcast on LIBOR transition on January 20, 2020. The article is available [here](#).
- The Treasury Markets Association has published the consultation conclusion on technical refinements to Hong Kong Dollar Overnight Index Average (HONIA). The report is available [here](#).

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## Contact Us

For further details on how we can help firms experience an effective transition away from LIBOR, please visit our website:

[DELOITTE LIBOR TRANSITION WEBSITE](#)

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