



Deloitteⁱ US LIBOR Transition Newsletter

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

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Executive Summary

The United States Department of the Treasury (USDT) and the Internal Revenue Service (IRS) jointly issued “Revenue Procedure 2020-44” on October 8, 2020 aimed at providing taxpayers relief when modifying LIBOR and other IBOR-based contracts to incorporate fallback language recommended by the International Swap Dealers Association (ISDA), Alternative Reference Rates Committee (ARRC), or other industry guidance providers. This relief acknowledges the fact that replacing an interest rate like LIBOR in a financial contract may be previously deemed a taxable transaction for federal income tax purposes which has led to significant tax uncertainty for market participants looking to transition away from IBORs. In response, the IRS aims to provide relief for these contract modifications by not considering the incorporation of recommended fallback language as a taxable event.

The US dollar swaps market experienced record Secured Overnight Financing Rate (SOFR) swaps volumes after a successful Central Clearing House (CCP) “big bang” discounting switch from Effective Federal Funds Rate (EFFR) to SOFR on October 16, 2020. This switch, led by the London Clearing House (LCH) and the Chicago Mercantile Exchange (CME), resulted in high volumes of SOFR trades marking an important milestone in the markets’ transition away from LIBOR. SOFR swap volumes reduced basis volatility between SOFR and fed funds-linked swaps which assists in a smoother transition from LIBOR to SOFR.

ISDA launched the IBOR Fallbacks Supplement and IBOR Fallbacks Protocol on October 23, 2020 which is set to take effect on January 25, 2021. As of the effective date, the new ISDA fallbacks can be applied to all new derivative contracts which incorporate the 2006 ISDA Definitions. The new ISDA fallbacks can also be applied retrospectively to all existing derivative contracts if contractual parties have adhered to the ISDA Protocol or agree so bilaterally. This also marks a critical landmark in facilitating the transition away from LIBOR for market participants.

On October 28, 2020, NY State Senate Bill S9070 was released, which plans to update the State's Uniform Commercial Code (UCC) to accommodate for LIBOR cessation. If enacted, a new Article 12 in the UCC would, by operation of law, stipulate that upon LIBOR discontinuation all LIBOR-linked contracts may be updated to include a replacement benchmark rate and/or fallback provisions that reference such replacement benchmark rates. Contracts already linked to LIBOR successors (or with respective fallback language) would not be affected. In addition, according to the Senate's proposal, LIBOR discontinuance or the effects of implementing a recommended benchmark replacement is not intended to create a right to excuse or suspend performance, or result in breach of contract. A congressional bill drafted by Brad Sherman from California largely mimics legislation introduced in the New York State.

Key Upcoming Dates

- **January 25, 2021** – ISDA's expected effective date of the IBOR Fallbacks Supplement and the IBOR Fallbacks Protocol.



Our Perspective

The USDT and IRS Provides Relief for LIBOR Transition

The USDT and IRS have issued the long-awaited tax relief which applies to any IBOR-linked contract that is modified to incorporate an ARRC Fallback Provision, an ISDA Fallback Provision or other industry recommended Fallback Provisions with certain deviations. The IBOR revenue procedure provides that the modification of a contract to incorporate a qualifying fallback provision can help avoid a taxable event for US tax purposes, which provides significant relief to organizations as fallbacks are starting to be incorporated into contracts. The relief was issued a few weeks before the ISDA protocol launch date of October 23, 2020 providing organizations with the necessary tax guidance in order to help minimize tax impacts related to adhering to the ISDA protocol. Although this relief would alleviate some concerns on tax implications, we encourage firms to consult their tax professionals on scenarios and types of amendments being made as some additional changes to contracts may not be covered under the relief.

CCP EFR to SOFR Discounting Rate Change Increases SOFR Trading Volume

As one of the final activities of the ARRC Paced Transition Plan, the CCP SOFR discounting switch and SOFR basis swap auction was completed over the weekend of October 16, 2020 and was reported to be successful. With firms exposed to SOFR through discounting and firms now having more exposure to SOFR basis swaps, there was an increase in trading volumes of SOFR-linked products with CME reporting a 12% increase in open interest for SOFR futures in the 7 days between October 12 and October 20, 2020. Although there is more open interest, the market may require additional traction across the various tenors in the futures, swap and other derivative markets for more data to be generated for a SOFR forward-looking term rate to be feasible.

ISDA's Launch of the IBOR Fallbacks Protocol and IBOR Fallbacks Supplement

ISDA's 2020 IBOR Fallbacks Protocol and IBOR Fallbacks Supplement are considered a significant step in the transition to LIBOR. The protocol, which is essentially a multilateral contractual agreement that helps amend existing IBOR references to include ISDA fallback language, can serve as a practical way to facilitate wide-ranging preparation for IBOR cessation. Firms can have until January 2021 to review and sign into the Protocol. Parties adhering to the Protocol can automatically apply ISDA's supplement (i.e. the amendment to the 2006 ISDA definitions for interest rate and currency derivative transactions) to existing transactions and can reduce potential systemic risk.

NY State Senate Bill S9070 on the Amendment of the UCC Related to the Effect of a LIBOR Discontinuance

The senate's proposal is a long-awaited step to address some of the toughest challenges in the transition away from LIBOR. Similar initiatives are underway on a federal level. The legislation would override existing benchmark rates and fallbacks that reference LIBOR-based benchmark rates, which are set to be discontinued, in favor of benchmark replacement rates recommended by the Federal Reserve Board (FRB) and ARRC. Therefore, it may likely shield any contractual changes regarding benchmark rate references and/or fallback language from liability, contractual triggering events, and performance disruption.



Regulatory Updates

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 October 1, 2020 until October 31, 2020. 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:

US Floating Rate Securities and CUSIP Numbers

- If a US floating rate security includes the ARRC fallback language, these fallbacks can immediately convert upon the first reset date. A round table plans to be held to finalize operational issues including what happens to securities' CUSIP (Committee on Uniform Securities Identification Procedures) numbers, but it is likely these numbers may be preserved to minimize market disruption.

Margin and Credit Pricing

- Margin and credit are intended to be priced in a competitive and transparent manner in the market. This may allow borrowers to competitively obtain credit and lenders can have a clear assessment of the risk they face.

Payment Delays and Late Payments

- In swaps markets, which regularly uses payment delays, no interest is charged on the payment delay period. The payment is based off the notional and does not continue compounding during the delay. In the loan space, however, late payments do not continue compounding interest, rather a late payment fee structure is set in place.

Administrative Agent Notification for Cessation and Pre-Cessation Events

- A cessation event entails a statement by the Administrator, Regulator or governing authority that LIBOR has or plans to cease to exist in the future. A pre-cessation event, on the other hand, entails a statement by the FCA that LIBOR is no longer representative. There are historical reasons for the differences in the definitions. Prior to the ARRC beginning work on the updated fallback language, pre-cessation triggers did not exist. In either scenario, contracts under both the ARRC and ISDA are essentially treated the same. The main difference arises in the notices section where administrative agents are required to notify borrowers and other affected parties that a cessation event has been announced, while no such requirement exists for a pre-cessation announcement.

ARRC Recommended Fallback Language for Municipal Bonds

- The ARRC considers municipal floating rate debt similar to floating rate notes (FRN) and FRN language can be applied to those instruments. Under the currently proposed New York State legislation, parties which hold discretion to name a new rate can be granted safe harbor when selecting the ARRC fallback rate.

Non-Zero Floors and Compounding

- For legacy loans which fall back from LIBOR to compound SOFR in arrears, the LIBOR-SOFR spread adjustment may be considered when setting floors to achieve the same result. If the LIBOR floor is set at 1% and the spread adjustment is 20 basis point, the floor for the compound daily SOFR as 80 basis points which results in the same 1% LIBOR floor. When instituting compound SOFR in arrears, the ARRC recommends compounding SOFR but treating the spread adjustment as simple interest.

Regulatory Highlights

- The USDT and the IRS issued "Revenue Procedure 2020-44" aimed at providing taxpayers relief when modifying LIBOR and other IBOR-based contracts. The relief is available [here](#).
- The US dollar swaps market experienced record SOFR swaps volumes after a successful CCP "big bang" discounting switch from EFR to SOFR. The article is available [here](#).
- ISDA launched the IBOR Fallbacks Supplement and IBOR Fallbacks Protocol on October 23, 2020. The statement is available [here](#).
- On October 28, 2020, NY State Senate Bill S9070 was released, which plans to update the State's UCC to accommodate for LIBOR cessation. The bill is available [here](#).
- Congress drafted a federal legislative solution for California related to tough legacy LIBOR contracts. The article is available [here](#).

ARRC Working Group

- The ARRC issued a statement on the ISDA IBOR Fallbacks Protocol and encouragement of timely adherence. The statement is available [here](#).
- The ARRC published FAQs regarding RFPs for the publication of forward-looking term SOFR rates. The FAQ is available [here](#).
- The ARRC published FAQs regarding the RFP for the Administration of Recommended Spread Adjustments and Spread-Adjusted SOFR rates to facilitate contractual fallbacks. The FAQ is available [here](#).
- The ARRC published their August-September newsletter. The newsletter is available [here](#).
- ARRC updated the general FAQs. The FAQs are available [here](#).

ISDA Updates

- ISDA published their RFR conventions and IBOR fallbacks product table. The conventions are available [here](#).
- Bloomberg's official ISDA IBOR fallback rates data was published. The rates are available [here](#).
- ISDA issued a statement on the launch of the IBOR Fallbacks Supplement and IBOR Fallbacks Protocol. The statement is available [here](#).
- ISDA published their IBOR Alternative Reference Rates October Disclosure Annex. The disclosure is available [here](#).
- ISDA published their ISDA-Clarus RFR Adoption Indicator for September 2020. The indicator is available [here](#).
- ISDA published the 2020 IBOR Fallbacks Protocol list of adhering parties. The list is available [here](#).
- ISDA published their comments on the launch of the Fallbacks Supplement and Protocol. The statement is available [here](#).
- ISDA published their introductory video on benchmark fallbacks. The video is available [here](#).

Other News/ Useful Reading

- The Department of Justice (DoJ) gives the green light to move forward with the ISDA Protocol. The article is available [here](#).
- Commodities Futures Trading Commission (CFTC) provided reporting relief for swaps related the DCO auctions as part of the transition away from LIBOR. The two no-action letters and statement are available [here](#).
- Two-month delay to ISDA fallback protocol leaves FCA's planned end-2020 statement in the balance. The article is available [here](#).
- Numerix published a visual analysis of the LIBOR transition divided into 3 chapters. Chapter 1 is available [here](#), Chapter 2 is available [here](#), and Chapter 3 is available [here](#).
- An exodus of assets from prime money market funds could obstruct efforts to build credit-sensitive alternative reference rates in the US dollar market. The article is available [here](#).
- Financial Stability Board (FSB) published a roadmap and an article for global transition from LIBOR. The article is available [here](#) and roadmap available [here](#).
- The Federal Farm Credit Banks Funding Corporation (FFCB) is asking bondholders to approve new fallback language for \$1.9 billion of floating rate notes (FRNs), which would re-hitch coupons to the secured overnight financing rate, or SOFR, on Libor's demise. The article is available [here](#).
- CFTC releases no-action letters offering further relief for clearing organisations during LIBOR transition. The article is available [here](#).
- Intercontinental Exchange (ICE) has launched a consultation seeking feedback on the treatment of open contracts in LIBOR based futures contracts upon the transition away from LIBOR. The circular is available [here](#).
- CCP discount switch drives record SOFR swap volumes. The article is available [here](#).



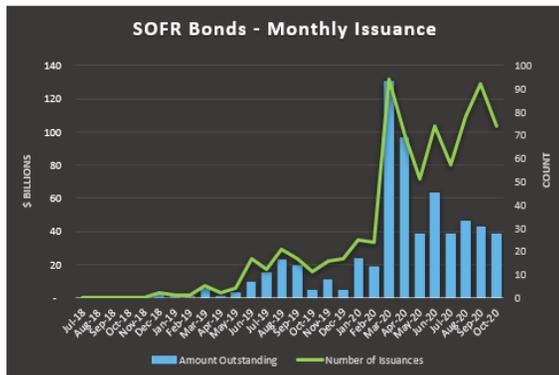
Market Updates

Decrease in Debt Issuance Referenced to SOFR

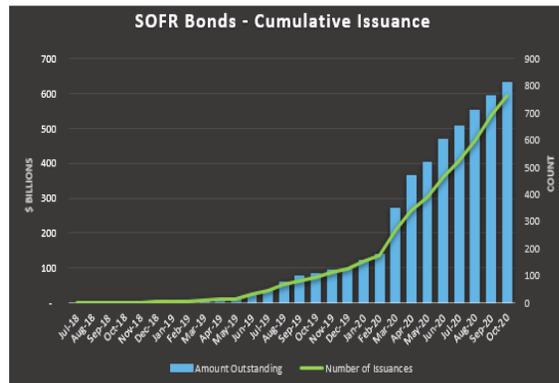
The issuance size of SOFR referenced debt decreased in October 2020 compared to the issuances in September 2020. The issuance was \$38 billion in October 2020 which decreased from \$42.3 billion in September 2020. The graphs below represent data through October 30, 2020.

The cumulative issue size of SOFR bonds outstanding (this excludes matured bonds) is currently \$645.4 billion with 788 bonds through November 11, 2020. There were 77 new issuances in October 2020 compared to 93 and 77 issuances in September 2020 and August 2020 respectively.

In October 2020, federal agencies issued 29 SOFR referenced Floating Rate Notes (FRNs) worth \$19.67 billion. There were 42 other institutions which contributed \$19.97 billion to the outstanding amount of SOFR referenced debt.



Source: Bloomberg, compiled by Deloitte
*Data as of Oct 30, 2020

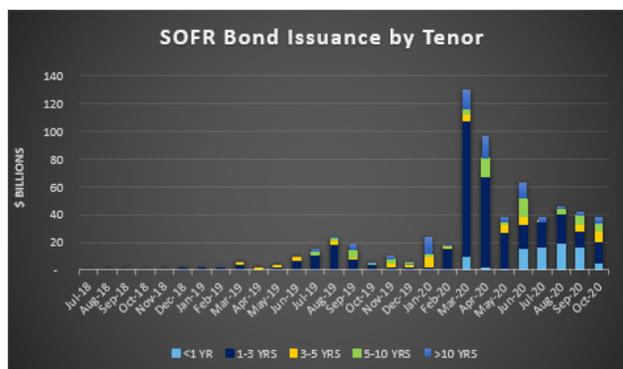


Source: Bloomberg, compiled by Deloitte
*Data as of Oct 30, 2020

Increase in Longer Dated Debt issuance (maturity >=5 years) referenced to SOFR

SOFR debt issuances with a maturity greater than or equal to five years increased in October 2020 compared to the previous month of September 2020. During October 2020, there were 8 bonds issued which have a maturity between five and ten years. The issuances during October 2020 includes 31 bonds with an amount outstanding of \$5.22 billion which have a maturity greater than or equal to ten years, which has increased as compared to \$2.74 billion in September 2020.

There were 251 issuances of SOFR bonds outstanding worth \$146.1 billion, with a maturity greater than or equal to five years, through November 11, 2020 including 202 issuances worth \$88.3 billion with a term greater than or equal to 10 years.

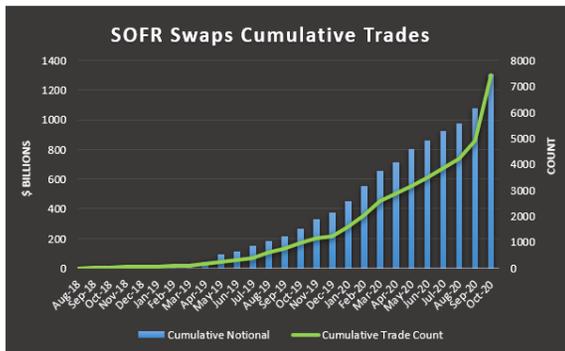


Source: Bloomberg, compiled by Deloitte
*Data as of Oct 30, 2020

Cumulative SOFR Interest Rate Derivatives

SOFR Swaps

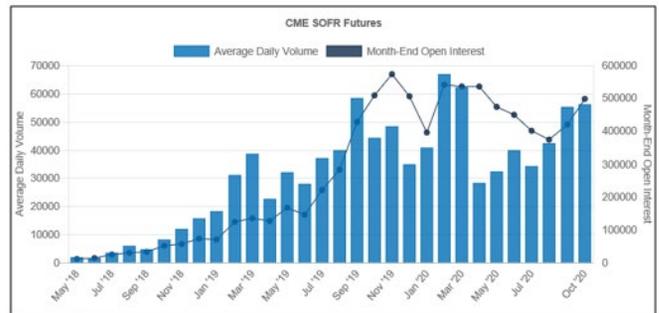
- The cumulative traded notional for SOFR based interest rate and basis swaps totaled \$1309.5 billion through October 30, 2020.
- For the month of October 2020, the notional volume of SOFR-based interest rate and basis swaps totaled \$231.2 billion compared to the \$100 billion in September 2020, and \$54.3 billion in August 2020. Trading volumes in October increased as market participants managed exposure around the OTC markets' transition to SOFR discounting that took place on October 16.



Source: <http://swapsinfo.org/>, compiled by Deloitte
*Data as of Oct 30, 2020

SOFR Futures

- As per the data available on CME, for October 2020, SOFR futures average daily volume reached 56K contracts/ day. The data is available [here](#).
- The month-end open interest for October 2020 was around ~500K contracts. The data is available [here](#).



Source: CME Group
*Data as of Oct 30, 2020

Global IBOR Activity

The market activity in Sterling Overnight Index Average (SONIA), Swiss Average Rate Overnight (SARON) and Euro Short-Term Rate (€STR) based debt issuances and swaps continues to increase. The table below represents the cumulative bond issuances (does not exclude matured bonds) and the cumulative notional of swaps outstanding through October 30, 2020.

Alternative Reference Rate	Swaps Cumulative notional amount (US \$ Billions)	Bonds Cumulative issuance amount (US \$ Billions)
SONIA	30,596.5	91.9
SARON	57.7	NA
TONA	568.7	NA
€STR	57.1	4.2

Source: Bloomberg, <http://swapsinfo.org/>, compiled by Deloitte
Data as of October 30, 2020



Global Highlights

United Kingdom

- Bank of England (BoE) Working Group issued a statement on the ISDA IBOR Fallbacks Protocol. The statement is available [here](#).
- BoE published their term SONIA reference rate publication summary. The presentation is available [here](#).
- BoE published their summary of freely available independent RFR calculators. The calculators is available [here](#).
- The UK government introduced the Financial Services Bill to Parliament. This Bill includes amendments to the Benchmarks Regulation (BMR), which provide the Financial Conduct Authority (the FCA) with new and enhanced powers to oversee the orderly wind-down of critical benchmarks, such as LIBOR. The policy statement is available [here](#), and the policy paper is available [here](#).
- FCA issued a press release welcoming proposed amendments to the UK Financial Services Bill. The press release is available [here](#).
- The FCA and BoE encourage market participants in further switch to SONIA in interest rate swap markets. The joint statement is available [here](#).
- BoE published their Sterling Working Group September 2020 newsletter. The newsletter is available [here](#).

European Union

- Executive summary of the September 29, 2020 meeting of the National Working Group on Swiss Franc Reference Rates was published. The report is available [here](#).
- European Council issued a press release on proposed amendments to Benchmark Regulation addressing LIBOR cessation. The press release is available [here](#).
- Summary of responses to the European Central Bank (ECB)'s public consultation on the publication of compounded term rates using the €STR were published. The report is available [here](#).
- Association for Financial Markets in Europe (AFME) published the EURIBOR Benchmark Rate Modification Language for Securitization issuances. The benchmark language is available [here](#).

Asia

- Hong Kong Monetary Authority (HKMA) circular on customer production during the LIBOR transition. The statement is available [here](#).
- HKMA published a circular on adherence to the ISDA IBOR Fallbacks Protocol. The statement is available [here](#).
- Singapore publishes timelines, guidance to support transition to Singapore Overnight Average Rate (SORA). The article is available [here](#).
- Regulations Asia published an article on Asia's LIBOR transition progress. The article is available [here](#).
- Singapore needs to accelerate use of new benchmark interest rate. The article is available [here](#).

Australia

- Australia's market regulator, The Australian Securities and Investments Commission (ASIC), will publish guidance on firm's conduct obligations during the LIBOR transition. The article is available [here](#).

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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