



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

On July 13, 2021, the Commodity Futures Trading Commission’s (CFTC’s) Market Risk Advisory Committee (MRAC) adopted the “SOFR First” market best practice. SOFR First has four phases in its overall initiative of switching market conventions. In the first phase, coming into effect on July 26, 2021, the interdealer brokers will replace the trading of LIBOR linear Swaps with the trading of Secured Overnight Financing Rate (SOFR) linear Swaps. In the following phases, similar conventions are expected to switch for cross-currency swaps, non-linear derivatives, and exchange-traded derivatives. The Interest Rate Benchmark Subcommittee of CFTC’s MRAC developed these conventions to decrease the market participants’ reliance on USD LIBOR. The Alternative Reference Rates Committee (ARRC) commended the unanimous vote to formally adopt SOFR First, calling it a “milestone moment” towards prioritizing trading in SOFR derivatives in the effort of transitioning away from USD LIBOR.

On July 5, 2021, Edwin Schooling Latter of the Financial Conduct Authority (FCA) delivered a keynote speech with 6-months to go until Sterling London Interbank Offered Rate (LIBOR) cessation. Referring to the LIBOR Transition as a "marathon", Latter highlighted the key challenges that were overcome since Andrew Bailey's letter in 2017 including: (1) transfer of liquidity from LIBOR to benchmark rates, (2) requirement and preference of term-rates over overnight rates, (3) complications associated with value transfer and conversions and (4) ensuring that all legacy contracts that could be converted are being converted by end of 2021. Noting the success so far, Latter mentioned that even 6 months before the end of the sterling LIBOR panel, approximately 75% of new cleared sterling swap activity and almost half of cleared sterling notional outstanding is based on Sterling Overnight Index Average (SONIA). Latter further highlighted that the initiative in the US is SOFR First, and encouraged participants to look carefully at the risks associated with Credit Sensitive Rates (CSR) such as the Bloomberg Short-Term Bank Yield Index (BSBY). He noted that the CSR's reflect similar flaws of LIBOR while rates such as SOFR and SONIA have shown to be robust in times when the liquidity in the products underlying CSR dries up.

The Federal Housing Finance Agency (FHFA) on July 1, 2021, wrote a supervisory letter to the Federal Home Loan Banks (FHL Banks) to support a smooth transition away from USD LIBOR. The FHFA referred to SOFR as 'appropriate and well-accepted' replacement and warned against alternative rates that have the same shortcomings of USD LIBOR. In a separate announcement, the ARRC welcomed the FHFA's supervisory letter and appreciated the leadership and support of the FHFA in the transition from LIBOR to SOFR. The letter provided further guidance to the FHLBanks regarding considerations to be considered before choosing an alternative rate. The considerations included: (1) volume of underlying transactions, (2) credit sensitivity, (3) model risk, (4) contractual fallback language and, (5) depth of derivative markets.

On June 11, 2021, U.S. Securities and Exchange Commission (SEC) Chair Gary Gensler shared remarks prepared for the Financial Stability Overnight Council (FSOC) on his concerns over BSBY. Gensler cited similar flaws between BSBY and LIBOR that both benchmarks are based on unsecured, term bank-to-bank lending and both rates have a modest market that are not only thin in good times but virtually disappear during crisis. He noted that BSBY is not a robust rate, that it can be susceptible to the kind of manipulation that LIBOR faced, and for these reasons expressed his belief that SOFR is the better alternative.



Our Perspective

CFTC's MRAC formally adopts SOFR First

The CFTC's SOFR First initiative and the ARRC's support for it can serve to increase the momentum of migrating to SOFR linked trades. As noted from the FCA's keynote address, nearly 50% of traded notional in Sterling are based on SONIA, while the trading for SOFR lags far behind. The MRAC's unanimous vote for formal adoption of the recommendation will serve to encourage dealers to increase the trading activity in SOFR, promote liquidity in the SOFR market, and eventually lead to an ARRC recommendation to adopt the Chicago Mercantile Exchange (CME SOFR term rate for cash markets which is widely anticipated to occur soon after the SOFR First launch.

Edwin Schooling Latter's keynote: "LIBOR – 6 Months to go"

The keynote speech by FCA's Director of Markets and Whole Policy comes at an opportune time when a large subset of challenges related to LIBOR Transition have been overcome, and when there is more clarity on the transition (including clarity on the dates of cessation and clarity on legacy contracts) than ever before. The speech addresses the status-quo of the transition from LIBOR, both in sterling market and overseas. Latter's speech also encourages participants in the US to adopt a 'SOFR First' mindset to complement the efforts of ARRC and advises to consider the risks associated with CSR's due to their similarities to LIBOR.

The ARRC welcomes the FHFA Supervisory Letter

In recent months some market participants, especially in the lending business, have shown a greater inclination towards CSRs due to their credit sensitivity and term structure features. In expressing their interest in CSRs such as BSBY, it is important for market participants to identify key considerations while choosing a rate other than SOFR. The FHFA letter not only identifies these considerations but proceeds to provide guidance on how these need to be accounted for (e.g. verifying whether the rate has sufficient correlation with bank's funding costs). The FHFA letter has come in time as the 'SOFR First' switch and an eventual SOFR term rate is weeks away.

Current Developments for CSRs

Bloomberg published a paper with the intent to further inform public-sector and industry-level discussion around how CSRs—including BSBY—can facilitate benchmark transition. In the paper, Bloomberg documented the requirements and preference for CSRs in the lending market, the acceptance and co-existence of both CSRs and risk free rates in markets around the world, BSBY's resilience to manipulation, and its fundamental and structural difference from LIBOR. This paper has been published around the time when regulators have been outspoken in their opinion to discourage the use of CSRs and promote the use of SOFR. Whether the market participants adopt CSRs despite the SOFR First recommendation and regulatory warnings remain to be seen post July 26, 2021.



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 June 1, 2021 until June 30, 2021. Weekly office hour information can be found [here](#). The information below does not represent the view of the FRB but represents the personal views of David Bowman outside of his official capacity. Below are some of the specific topics discussed:

SOFR Term Rate: Timing, Tenors and Scope

- The ARRC has historically pointed to 2 places which have a clearest need for the term rate: (1) legacy cash/consumer products, and, (2) business loans where consumers have a difficulty in adapting. The ARRC has pointed to recommendation for spread adjustments for legacy products and pointed to the ARRC waterfall. If there is no recommended term rate for a specific tenor, the user would have to use SOFR in advance. Currently, the ARRC has not recommended a scope of use and nothing is prohibiting participants from using the CME term rate.

Operational Switch from LIBOR Term Structure to 'SOFR First'

- From an interdealer broker market point of view, one would be able to quote LIBOR-SOFR basis swaps on interdealer screens (e.g. one can have 1 SOFR swap and 1 LIBOR-SOFR basis swap, and thus one will be able to quote LIBOR on the interdealer broker screen). But it may not be sufficient to get the LIBOR term structure using just that. However, this does not mean one cannot construct a LIBOR curve. For an end-user there is no forced operational move to LIBOR. However, someone quoting LIBOR will have to move to SOFR soon.

Achieving All Market Indicators Within 'Days Not Weeks' of SOFR First

- The message of 'days not weeks to recommend a term rate' depends on the ARRC recommended market indicators. The move of interdealer conventions was the most observable step/precursor. The other two market indicators will still have to be met. Firstly, SOFR derivative trades needs to grow and the growth seems likely. The SOFR derivative market has been growing (cumulative notional have approximately doubled in 2021), however it is still small compared to LIBOR. Secondly, there must be continued growth of SOFR in loan and cash market. There are signs of growth as deals are visible in securitization and business loans.

Securities Industry and Financial Markets Association (SIFMA) Calendar Business Days, Holidays and Compounding in Arrears

- For compounded SOFR in arrears, one has to compound over SOFR business days (i.e. days when SOFR is published and the US Securities Trading is not fully closed). Thus, one would compound over days when SOFR is available and interest period will follow the US business day calendar. Similar approach is to be taken for SONIA.

USD LIBOR Extension and Spread Adjustment Refresh

- There are no plans to refresh the spread adjustments (neither closer to the cessation date nor on a recurring basis) given the extension of certain tenors of USD LIBOR to June 2021. Once the statement from IBA and UK FCA on March 5, 2021 was announced, the spreads were set. The ISDA spreads for the required tenor are to be used for non-consumer cash products. Term SOFR is essentially the market's expectation of SOFR compounded in arrears over the required period and hence it has the same basic expected value.

Shorter Form Hardwired Language for Syndicated and Bilateral Business Loans

- In the shorter form hardwired language for syndicated and bilateral business loans, the section dealing with spread adjustment for term SOFR states the ISDA spread numbers, but it wasn't done for daily simple SOFR. The intent here was to document the shortest form possible and came down on the side of fewer words, but the outcome is meant to be the same as ISDA spread adjustment.

Recommended Spread for Early Opt-In

- If both parties want an early opt in, the ARRC's recommendation is to choose the fixed spread. As soon as the spread was fixed, that value should be used.

Regulatory Highlights

- CFTC's MRAC adopted the recommendation of SOFR First at a public meeting. The statement is available [here](#).
- Keynote speech by Edwin Schooling Latter, Director of Markets and Wholesale Policy at the FCA, delivered at UK Finance's Commercial Finance Week on July 5, 2021 was published by the FCA. The speech is available [here](#).
- The ARRC welcomed the FHFA Supervisory Letter on Transition Away from LIBOR. The article is available [here](#).
- ComplianceWeek published an article titled "SEC's Gary Gensler stumps for SOFR, shares concerns with Bloomberg rate". The article is available [here](#).

ARRC Updates

- The ARRC welcomed and highlighted the key points made during the FSOC Principals Meeting on June 11, 2021. The statement is available [here](#).
- The ARRC welcomed the MRAC subcommittee's recommended dates for transitioning interdealer swap market trading conventions to SOFR. The statement is available [here](#).
- The ARRC commended the CFTC MRAC's Formal Adoption of SOFR First. The statement is available [here](#).
- The ARRC published the minutes from its meeting on May 19, 2021. The minutes are available [here](#).
- The ARRC published the agenda for the meeting held on June 17, 2021. The agenda is available [here](#).

International Swaps and Derivatives Association (ISDA) Updates

- ISDA published a consultation on the fallbacks for GBP LIBOR Intercontinental Exchange (ICE) Swap Rate and the USD LIBOR ICE Swap Rate. The consultation is available [here](#).
- ISDA published first digital definitions for interest rate derivatives. The press release is available [here](#).
- ISDA published their ISDA-Clarus RFR Adoption Indicator for May 2021. The report is available [here](#).
- ISDA hosted a webinar and Q&A on the consultation on fallbacks for GBP LIBOR ICE Swap Rate and USD LIBOR ICE Swap Rate. The recording is available [here](#).

ICE/CME Updates

- CME published the June 2021 rates recap market summary. The report is available [here](#).
- CME published their announcement on BSBY Futures. The announcement is available [here](#).
- ICE published the May Interest Rates Report. The report is available [here](#).
- ICE Benchmark Administration (IBA) has been selected by the UK's FCA to provide forward-looking term SONIA inputs for a proposed synthetic LIBOR. The article is available [here](#).

Other News/ Useful Reading

- Department of Treasury FSOC released a webcast covering LIBOR and CSRs. The webcast is available [here](#).
- The SEC published the remarks prepared before the FSOC meeting. The statement is available [here](#).
- The Financial Stability Board (FSB) issued a statement on smooth and timely transition away from LIBOR. The statement is available [here](#).
- CFTC's interest rate benchmark reform subcommittee issued a recommendation selecting July 26, 2021 as the transition date for interdealer swap market trading conventions from LIBOR to SOFR. The press release is available [here](#).
- FSB updated their global transition roadmap. The roadmap is available [here](#).
- FSB published a report on overnight risk-free rates and term rates. The report is available [here](#).
- FSB Official Sector Steering Group (OSSG) published a statement on the use of ISDA spread adjustments in cash products. The statement is available [here](#).
- The SEC published the remarks prepared before the FSOC meeting. The statement is available [here](#).
- International Organization of Securities Commissions (IOSCO) issued a statement on the benchmark transition. The statement is available [here](#).
- Department of Treasury FSOC released a webcast covering LIBOR and CSRs. The webcast is available [here](#).
- "ARRC eyes July 'SOFR first' switch". The article is available [here](#).
- "Wall Street warned by U.S. regulators to speed up LIBOR exit". The article is available [here](#).
- "U.S. regulators urge financial firms to quickly ditch LIBOR rate benchmarks". The article is available [here](#).
- "Top US regulators pledge to seek reforms for money markets". The article is available [here](#).
- "Regulators tell banks it is time to stop using LIBOR". The article is available [here](#).
- "Block trade tied to LIBOR's heir presumptive provides a jolt". The article is available [here](#).
- "U.S. financial regulators push banks to transition away from LIBOR". The article is available [here](#).
- "Leaving LIBOR: A landmark transition". The article is available [here](#).
- "LIBOR replacement stakes: runners and riders". The article is available [here](#).
- "CFTC probe into swap price rigging revives the ghosts of LIBOR manipulation". The article is available [here](#).



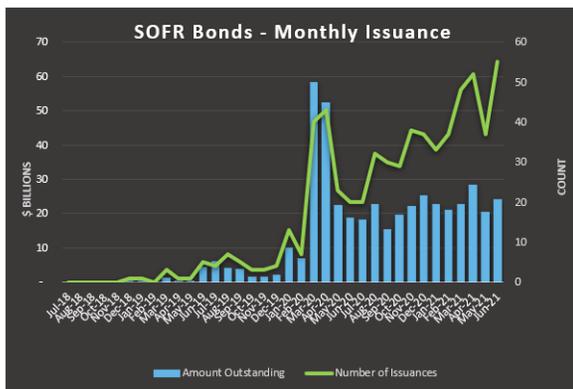
* Please note that the change in numbers and trend lines for bonds compared to figures in previous newsletters is due to change in the data source. Issuance data for bonds has been sourced from Reuters.

Increase in Debt Issuance Referenced to SOFR

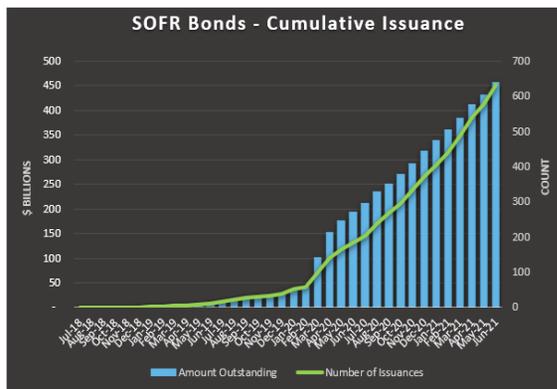
The issuance of SOFR referenced debt increased in June 2021 compared to issuance in May 2021. The issuance size was \$24.19 billion in June 2021, which increased from \$20.27 billion in May 2021. The graphs below represent data through June 30, 2021.

The cumulative issue size of SOFR bonds outstanding (this excludes matured bonds) is currently \$462.80 billion with 642 bonds through July 14, 2021. There were 55 new issuances in June 2021 compared to 37 in May 2021 and 52 in April 2021.

In June 2021, federal agencies issued 24 SOFR referenced Floating Rate Notes (FRNs) worth \$10.08 billion. There were 31 issuances from other institutions which contributed \$14.11 billion to the outstanding amount of SOFR referenced debt.



Source: Reuters, compiled by Deloitte
*Data as of June 30, 2021

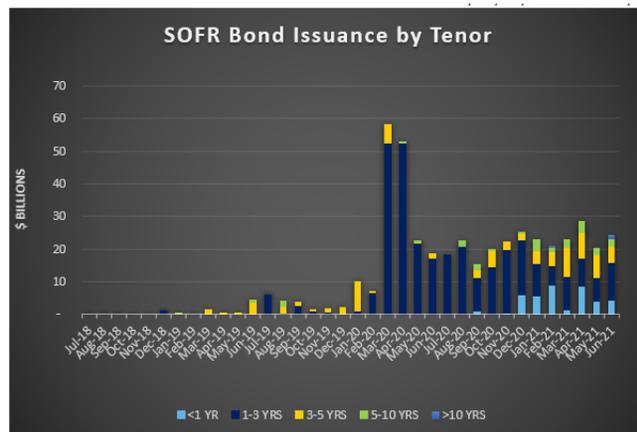


Source: Reuters, compiled by Deloitte
*Data as of June 30, 2021

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 June 2021 compared to May 2021. During June 2021, there were eight bonds issued which have a maturity between five and ten years. two bonds were issued during June 2021 that have a maturity greater than or equal to ten years, as compared to no issuances in May 2021.

There were 51 issuances of SOFR bonds outstanding worth \$23.52 billion, with a maturity greater than or equal to five years, through July 14, 2021 including five issuances worth \$1.87 billion with a term greater than or equal to ten years.

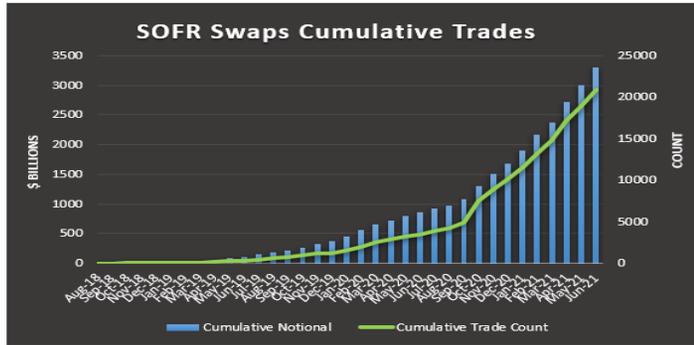


Source: Reuters, compiled by Deloitte
*Data as of June 30, 2021

Cumulative SOFR Interest Rate Derivatives

SOFR Swaps

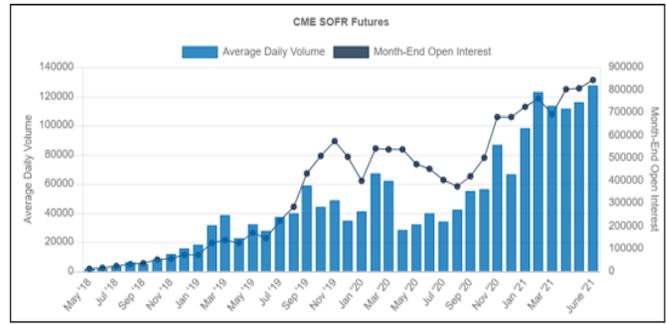
- The cumulative outstanding notional amount for SOFR based interest rate and basis swaps totaled \$3,300 billion through June 30, 2021.
- For the month of June 2021, the notional volume of SOFR-based interest rate and basis swaps totaled \$293 billion compared to \$289.4 billion in May 2021, and \$345.8 billion in April 2021.



Source: <http://swapsinfo.org/>, compiled by Deloitte
*Data as of June 30, 2021

SOFR Futures

- According to data available on CME, for June 2021, SOFR futures average daily volume reached 127K contracts/ day. The data is available [here](#).
- The month-end open interest for SOFR 1 month and 3 month futures as of June 2021 was ~841K contracts.



Source: CME Group
*Data as of June 30, 2021

Global IBOR Activity

The market activity in SONIA, Swiss Average Rate Overnight (SARON), Tokyo Overnight Average Rate (TONAR) and Euro Short-Term Rate (€STR) based debt issuances and swaps have continued to increase. The table below represents the cumulative bond issuances (does not exclude matured bonds) and the cumulative notional of swaps outstanding through June 30, 2021.

Alternative Reference Rate	Swaps Cumulative notional amount (US \$ Billions)	Bonds Cumulative issuance amount (US \$ Billions)
SONIA	39,428.3	124.0
SARON	76.9	NA
TONAR	734.5	NA
€STR	213.0	5.8

Source: Reuters, <http://swapsinfo.org/>, compiled by Deloitte
Data as of June 30, 2021



Global Highlights

United Kingdom

- The Bank of England (BoE)'s Working Group on Sterling Risk-Free Reference Rates (RFR WG) published the May 2021 newsletter. The newsletter is available [here](#).
- BoE's RFR WG published updates to the GBP LIBOR loan milestone Q&A. The report is available [here](#).
- The FCA published information for borrowers: mortgage interest rates and LIBOR. The report is available [here](#).
- The FCA and the BoE encouraged market participants to switch to SOFR in US dollar interest rate swap markets by July 26, 2021. The press release is available [here](#).
- The FCA consults on a proposed decision to require synthetic LIBOR for GBP and JPY settings. The article is available [here](#).
- BoE's RFR WG added a LIBOR cessation countdown timer to the working group home page. The countdown time is available [here](#).
- "BOE's Bailey says Sterling Libor switch is 'pretty much' there". The article is available [here](#).
- "SONIA futures analysis". The report is available [here](#).
- "Credit Agricole phases out LIBOR for SONIA with additional tier one (AT1) exchange". The article is available [here](#).

European Union

- The European Securities and Markets Authority (ESMA), European Commission, European Central Bank (ECB) and European Banking Authority (EBA) issued a joint statement on LIBOR cessation. The statement is available [here](#).
- "The statutory replacement of a benchmark". The article is available [here](#).
- "Swiss National Bank's (SNB's) Maechler says transition to SARON well on track, derivatives need work ". The article is available [here](#).

Asia

- The Monetary Authority of Singapore's (MSA) Steering Committee for SOR & SIBOR Transition to SORA (SC-STTS) released a webcast on the SORA transition for derivatives and corporate loans for banks with corporate customers. The webinar is available [here](#).
- "Development Bank of Singapore Limited (DBS) completes Singapore's first USD SOFR-linked export financing transaction". The article is available [here](#).
- "The Bank of Japan (BoJ) urges banks to speed up LIBOR transition plans". The article is available [here](#).
- "Chinese banks urged to stop using LIBOR as a benchmark for pricing USD loans". The article is available [here](#).
- "DBS and Standard Chartered execute Singapore's first SORA interbank option trade". The article details are available [here](#).

Australia

- Joint statements by Australian regulatory bodies were published on expectations for Australian institutions to cease the use of LIBOR in new contracts before the end of 2021. The articles are available [here](#), [here](#), and [here](#).
- Australian Securities and Investment Commission (ASIC) published IBOR transition and over the counter (OTC) derivatives transaction reporting requirements. The report 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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