



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 March 2, 2022, the Working Group on Euro Risk-Free Rates (WG-RFR) published a call for 'expression of interest' on the topic of fallbacks for Euro Interbank Offer Rate (EURIBOR) linked contracts. The WG-RFR was established by the European Central Bank (ECB), the Belgian Financial Services and Markets Authority (FSMA), the European Securities and Markets Authority (ESMA) and the European Commission. The EURIBOR fallback provisions have been a key priority item for the WG-RFR ever since it was tasked with identifying and recommending Euro RFRs. By means of this call for expression of interest, the WG-RFR has expressed interest in meeting and reviewing the presentations of any administrator that is developing Euro Short Term Rate (ESTR)-based, forward-looking term structure as a fallback in EURIBOR-linked contracts. All the presentations submitted to the WG-RFR will be made available on the ESMA website and the administrators will be invited to present and demonstrate their progress on June 17, 2022.

On March 17, 2022, the Currency Management Corporation (CMC) Markets' institutional arm (CMC Markets Connect) introduced a series of Sterling Overnight Index Average (SONIA) Futures as a benchmark contract to manage Sterling interest rate. Owing to this introduction, the company noted that SONIA is now fully embedded across Sterling markets in place of its predecessor (the interbank offered rates that were ceased in 2021). This move has enabled the Working Group on Sterling Risk-Free Reference Rates in the United Kingdom to achieve their mission to cease all GBP London Interbank Offered Rate (LIBOR) linked derivatives by the end of 2021. As of March 2022, only 2% of the legacy LIBOR stock still remain active, and the UK Central bank has noted that achieving a smooth transition of these residual products is now a key priority.

On April 4, 2022, Fitch Ratings reported that the Middle Market (MM) participants have made considerable progress in their transition from USD LIBOR. Fitch Ratings' analysis is based on a comprehensive study of 100 middle market issuers from its private rating portfolio, which show that these issuers have addressed LIBOR concerns in their existing credit agreements and ensured that automatic conversion to Alternate Base Rate (ABR) is now present in only 13% of these agreements. The report however noted that the MM participants still lag the Broadly Syndicated Loan (BSL) market in terms of adhering to the Alternative Reference Rates Committee's (ARRC's) recommended fallback language. Among the sampled list, 14% of MM participants adhered to the ARRC's Hardwired Approach, a number which is close to 28% in the BSL market.

On May 5, 2022, Chicago Mercantile Exchange Group (CME) announced a market-wide initiative called 'Secured Overnight Financing Rate (SOFR) First for Options', aimed to increase liquidity and accelerate adoption of SOFR options during the months of June and July. As part of this initiative, CME will undertake the following three key steps: (1) provide a market-wide fee waiver in the months of June and July, (2) provide market making incentives to enhance liquidity, and, (3) upon expiration, replace the long-dated quarterly Mid Curve and Eurodollar options with SOFR options. This move by the CME Group was lauded by regulators and market participants including the Financial Stability Board (FSB), Commodity Futures Trading Commission (CFTC) and the ARRC for taking the necessary steps to improve liquidity and encourage adoption of SOFR in a Post-LIBOR world.



Our Perspective

Call for Expression of Interest for EURIBOR fallbacks

In achieving a milestone of the magnitude of LIBOR transition, an industry-wide consensus on well-formulated ideas is a key step. ESMA's approach to invite interested administrators to present their ideas and demonstrate their progress is one such step to agree on a robust and forward-looking fallback language for all EURIBOR-linked contracts.

CMC Markets' move to improve SONIA liquidity

As CMC Markets is one of UK's biggest spread betting platform the introduction of SONIA index futures eases the transition to RFRs for some of their largest and well-established clients. Known commonly in startup circle as a 'Product-Market Fit' these introductions come as an appropriate fit for the market participants' requirements in a post-LIBOR world.

Middle Markets' active push toward USD LIBOR cessation

The proactive steps taken by middle market participants in their efforts to cease USD LIBOR are among the key milestones of an industry-wide preparation for a post-LIBOR world. However, it is worth noting that the approach followed by most of these participants is not completely in line with the ARRC's recommended hardwired approach.

Improving liquidity and adoption through SOFR First

With just over a year remaining for USD LIBOR cessation, the steps taken by CME are prudent and timely in order to accelerate the transition to exchange traded SOFR options market. The fact that this announcement is in line with the CFTC MRAC's SOFR First recommendation will encourage an increasing number of market participants to take advantage of this opportunity.



Regulatory Updates

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

This section represents a summary of the ARRC office hours Q&A with David Bowman from March 1, 2022 until April 30, 2022. 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:

Timeline of the Federal LIBOR rules

- The FRB has given 180 days to implement the rules as a result of the passing of legislation.

Consumer Loan Fallbacks in the Federal legislation

- The language included in Section 4 (E2) of the Federal legislation describes the rules for spread adjustments for consumer contracts.

Finalizing the details of ARRC recommendation

- The ARRC will finalize the details of its recommendation in Q2 and is on track to do so. The ARRC will make recommendations for consumer products (for Adjustable-Rate Mortgages) for 1M and 1Y LIBOR (1M LIBOR recommendations have already been finalized) by end of Q2. ARRC is currently deciding on whether 1Y Term Secured Overnight Financing Rate (SOFR) should be backed or not.

Pro-active v/s Reactive approach

- The ARRC will use a proactive approach where the investors and other seeks will be able to see the information beforehand. This applies to buy-side asset management firms (for securities already under management) who wish to seek clarification on how they would find out the new rates on the coupon payments post LIBOR cessation. The ARRC is actively working with Commodity Futures Trading Commission (CFTC) to determine the best approach as well and encourages market participants to reach out for specific clarifications.

Calculating the all-in rate

- In addition to the Request for Proposal (RFP) process for the Chicago Mercantile Exchange (CME) term rate (1,3, 6 months) administrator, ARRC had an RFP process for term rate administrator for the all-in rate. The administrator chosen for this rate was Refinitiv. Refinitiv is already producing an all-in rate (6 different index figures) based on ARRC recommended spread adjustment for non-consumer products. Refinitiv is still in the process to license the Term-SOFR rate, and the terms are under negotiation with CME. For consumer products, there will be a one-year transition period that will start on June 30, 2023. Before June 30, 2023, Refinitiv is prepared to produce beta-rates, which will not be live rates as LIBOR will still exist. In future, Refinitiv will publish the required rates for consumer products as well.

Federal Legislation and the Constant Maturity Swaps (CMS)

- The Intercontinental Exchange (ICE) USD LIBOR Swap Rate/ CMS rate are rates based off LIBOR swaps. ICE has indicated that those swap rates are expected to stop when LIBOR does. Although these are 'tied to LIBOR', these are 'not LIBOR', hence the FRB legislation does not cover them. If anyone has a contract that references those rates, there will not be a legislative solution for them, and they should actively address them. If it's a derivative contract, the International Swaps and Derivatives Association (ISDA) should have a solution for them that parties can use bilaterally and ARRC has provided recommendations of reasonable fallback based off SOFR. If one has a structured note referencing this rate, it is recommended that parties should think about ways to remediate these contracts before the rates stop. There are limited ways one can do this: one example would be to buy back the contract and replace with a SOFR-based one.

ARRC's endorsement on the term rate

- The ARRC is actively discussing the topic of endorsing the 12M CME Term SOFR rate. ARRC is expected (and has made a public commitment) to make all final decisions about fallback recommendations by June 30, 2022.

Regulatory Highlights

- CMC Market Connect's institutional business arm introduced Sonia index futures as the benchmark to manage Sterling interest rate risk. The article is available [here](#).
- Fitch Ratings published an article titled: "Middle market makes considerable progress in transition from LIBOR". The article is available [here](#).
- ESMA issued a call for 'expression of interest' on the topic of ESTR-based forward-looking term structures as a fallback in EURIBOR contracts. The ESMA release is available [here](#).
- CME Group announced the launch of 'SOFR First for Options', a market-wide initiative geared toward accelerating adoption and liquidity in SOFR options during the months of June and July. The details are available [here](#).

ARRC/ FRB Updates

- The ARRC released a statement on passage of Federal LIBOR Legislation. The statement is available [here](#).
- The ARRC released a readout of the March 23, 2022 meeting. The transcript is available [here](#).

ISDA Updates

- ISDA expanded ISDA Swapsinfo interest rate derivatives trading activity report for EU, UK, and US markets for December 2021. The report is available [here](#).
- ISDA published the ISDA-Clarus RFR Adoption Indicator for February 2022. The report is available [here](#).
- ISDA published the Swapsinfo weekly data including interest rate derivatives trading activity in EU and UK. The Swapsinfo report is available [here](#) and interest rate derivative data is available [here](#).
- ISDA published a report on the transition to RFR for the first quarter of 2022. The report is available [here](#).

ICE/ CME Updates

- CME released the March and April 2022 Rates Recap. The reports are available [here](#) and [here](#).
- CME released the Market Agreed Coupon (MAC) rates for JPY Tokyo Overnight Average Rate (TONAR). The report is available [here](#).
- ICE released the Interest Rates Report for February and March 2022. The reports are available [here](#) and [here](#).
- ICE Futures Europe published a circular on suspension from trading of USD LIBOR based futures contracts. The circular is available [here](#).

Other News/ Useful Reading

- Deloitte published an analysis of the Internal Revenue Services (IRS) final regulations providing guidance on transition from LIBOR. The report is available [here](#).
- "ABA applauds inclusion of LIBOR bill in omnibus bill". The article is available [here](#).
- "Congress passes ABA backed bill addressing tough legacy LIBOR contracts". The article is available [here](#).
- "LIBOR act protects US legacy contracts". The article is available [here](#).
- "From LIBOR to SOFR: What it means for markets". The article is available [here](#).
- "Congress passes legislation on LIBOR fix as part of \$1.5 trillion spending package". The article is available [here](#).
- "Risks persist with some LIBOR legacy contracts". The article is available [here](#).
- "CLO equity faces pain as leveraged loans lose SOFR compensation". The article is available [here](#).
- "More post-LIBOR accounting relief on horizon for hedgers". The article is available [here](#).
- "Valuation and risk management of vanilla LIBOR swaptions in a fallback". The article is available [here](#).
- "LIBOR transition progresses, but hurdles remain for legacy loans". The article is available [here](#).
- "Federal LIBOR legislation in five quick bites". The article is available [here](#).
- "Leaving LIBOR: SOFR Takes Over". The podcast is available [here](#).
- "Regional banks lead charge into term SOFR". The article is available [here](#).
- "Term SOFR restrictions spark valuation debate". The article is available [here](#).
- "Financial Accounting Standards Board (FASB) released a proposal for updates to reference rate reform guidance, including sunset date deferral and amendments to SOFR Overnight Indexed Swaps (OIS) rate definition. The proposal is available [here](#) and the article is available [here](#).
- "Emirates Global Aluminium announced the company agreed to a revolving credit facility tied to SOFR". The article is available [here](#).
- "More time offered on LIBOR accounting breaks as rate lingers". The article is available [here](#).
- "How SOFR futures and options liquidity is building". The article is available [here](#).
- "LIBOR successor on cusp of overtaking Eurodollar futures market". The article is available [here](#).



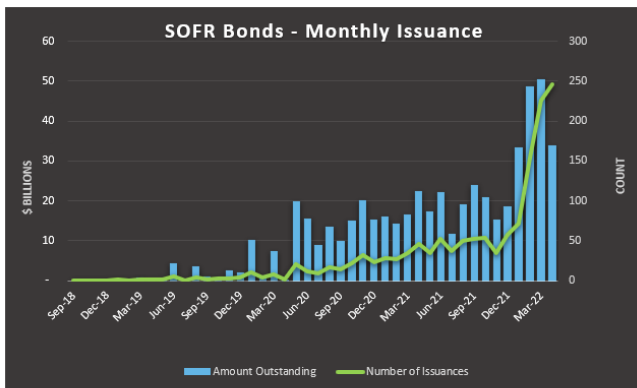
Market Updates

Decrease in Debt Issuance Referenced to SOFR

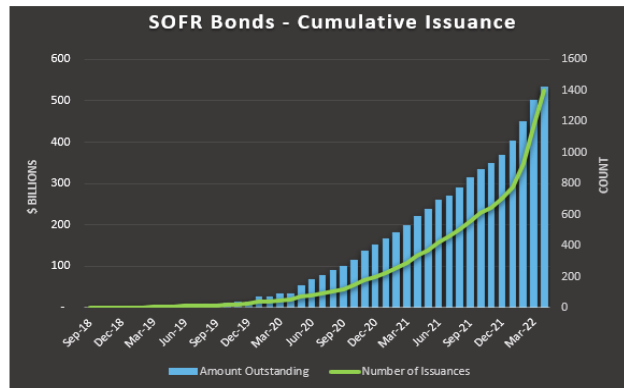
The issuance of SOFR referenced debt decreased in April 2022 compared to issuance in March 2022. The issuance size was \$33.9 billion in April 2022, which decreased from \$50.3 billion in March 2022. The graphs below represent data through April 2022.

The cumulative issue size of SOFR bonds outstanding (this excludes matured bonds) is currently \$529.8 billion with 1,496 bonds through May 11, 2022. There were 246 new issuances in April 2022 compared to 226 in March 2022 and 153 in February 2022.

In April 2022, federal agencies issued 24 SOFR referenced floating rate notes (FRN)s worth \$14.9 billion. There were 222 issuances from other institutions that contributed \$19 billion to the outstanding amount of SOFR referenced debt.



Source: Reuters, compiled by Deloitte
*Data as of April 30, 2022

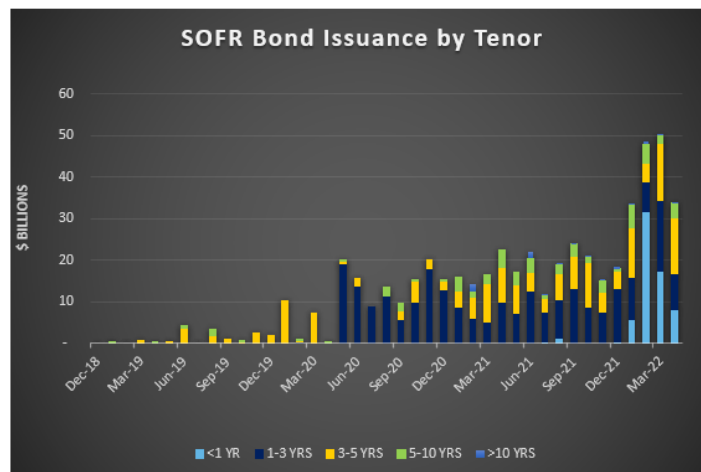


Source: Reuters, compiled by Deloitte
*Data as of April 30, 2022

Decrease in Longer Dated Debt Issuance (maturity ≥ 5 years) Referenced to SOFR

SOFR debt issuances with a maturity greater than or equal to five years decreased in April 2022 compared to March 2022. During April 2022, there were 12 bonds issued that have a maturity between five and 10 years, compared to 25 issuances in March 2022. There were 7 issuances during April 2022 that had a maturity greater than or equal to 10 years, as compared to 8 such issuances with a maturity greater than or equal to 10 years for March 2022.

There were 250 issuances of SOFR bonds outstanding worth \$55.81 billion, with a maturity greater than or equal to five years, through May 11, 2022 including 50 issuances worth \$5.3 billion with a term greater than or equal to 10 years.

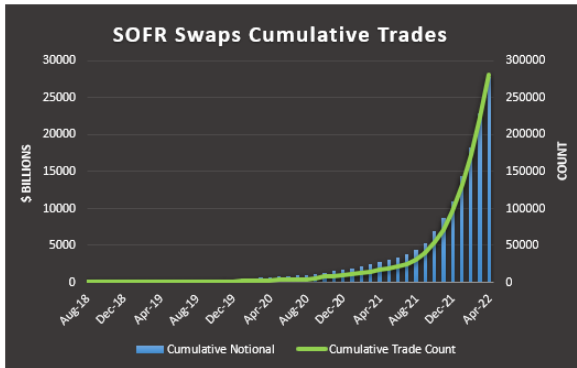


Source: Reuters, compiled by Deloitte
*Data as of April 30, 2022

Cumulative SOFR Interest Rate Derivatives

SOFR Swaps

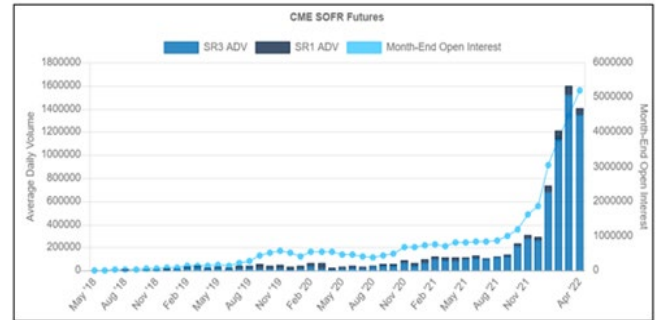
- The cumulative outstanding notional amount for SOFR based interest rate and basis swaps totaled \$27,845 billion through April 29, 2022.
- For the month of April 2022, the notional volume of SOFR-based interest rate and basis swaps totaled \$4,988.9 billion compared to \$4,659.1 billion in March 2022 and \$3,822.9 billion in February 2022.



Source: <http://swapsinfo.org/>, compiled by Deloitte
*Data as of April 29, 2022

SOFR Futures

- According to data available on CME, for April 2022, SOFR futures (including both one-month and three-month futures) average daily volume reached ~1.4M contracts/ day. The data is available [here](#).
- The month-end open interest for SOFR 1-month and 3-month futures as of April 2022 was ~5.2M contracts.



Source: CME Group
*Data as of April 30, 2022

Global IBOR Activity

The market activity in SONIA, TONAR, ESTR, and Swiss Average Rate Overnight (SARON) 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 April 30, 2022.

Alternative Reference Rate	Swaps Cumulative notional amount (US \$ Billions)	Bonds Cumulative issuance amount (US \$ Billions)
SONIA	60,134.9	166.1
SARON	530.3	NA
TONAR	2,663.5	NA
€STR	13,231.5	6.6

Source: Reuters, <http://swapsinfo.org/>, compiled by Deloitte
Data as of April 30, 2022



Global Highlights

United Kingdom

- CMC Market Connect's institutional business arm introduced Sonia index futures as the benchmark to manage Sterling interest rate risk. The article is available [here](#).

European Union

- The WG-RFR released their work programme for 2022/23. The report is available [here](#).
- ESMA released the minutes of March 2, 2022, working group meeting. The transcript is available [here](#).
- The FSB issued a statement welcoming smooth transition away from LIBOR. The statement is available [here](#).
- "LIBOR replacement a slow seller from the start". The article is available [here](#).
- "Swiss National Bank's (SNB's) Maechler says transition to SARON smooth and successful". The article is available [here](#).
- "EURIBOR enters into positive territory". The article is available [here](#).
- "EURIBOR, another tsunami on the way". The article is available [here](#).

Asia

- Bank Negara Malaysia launched the first transaction-based Islamic benchmark rate, Malaysia Islamic Overnight Rate (MYOR-i). The article is available [here](#).
- "Turkey's first SOFR loan from Garanti Banco Bilbao Vizcaya Argentaria (BBVA)". The article is available [here](#).
- "LIBOR transition challenges remain in Asia Pacific (APAC) loans market". The article is available [here](#).
- "Most financial institutions in Asia need until 2023 to scrap LIBOR benchmark". The article is available [here](#).
- "TaiFX-SOFR mismatch puts pressure on Taiwanese banks". 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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