



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

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

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### Executive Summary

In the Financial Conduct Authority's (FCA) September 2021 consultation paper (which sought commentary by October 20, 2021), the FCA noted that at least for the length of 2022, they are proposing the use of legacy synthetic Sterling (GBP) and Japanese Yen (JPY) London Interbank Offered Rate (LIBOR) in all contracts outside of derivatives. The clearing houses plan to transition all cleared LIBOR contracts to risk-free rates by end of 2021. The UK Financial Services Act 2021 amended the Benchmark Regulation (BMR) to allow the FCA to act when critical benchmarks are at risk of becoming unrepresentative and in situations where it may be impractical to help restore representativeness to the benchmark. In order to help facilitate an orderly cessation, the FCA may instruct a benchmark's administrator to continue to publish Article 23A benchmarks (i.e., critical benchmarks) under a different methodology (i.e., "synthetic LIBOR"). Under Article 21(3), the FCA can compel a benchmark administrator to continue publishing in this form up to 10 years. The consultation paper stressed the need for firms to continue to prioritize the transition away from LIBOR although efforts are being made to help with an orderly wind-down of LIBOR.

On October 21, 2021, the European Commission adopted the regulation of the replacement of Euro Overnight Index Average (EONIA) as part of their Commission Implementing Regulation European Union (EU) 2021/1848. EONIA is a critical benchmark that represents the interest rates of unsecured overnight lending transactions that are denominated in euros. A variety of contracts and financial instruments leverage EONIA, but on May 31, 2019, the European Money Market Institute (EMMI) announced the discontinuation of EONIA by January 3, 2022 as compliance of EONIA with Regulation 2016/1011 could not be achieved. A working group of the euro risk-free rates recommended the Euro Short-Term Rate (€STR) as the risk-free rate to replace EONIA. Despite the early alerts and work performed in getting ready for the transition from EONIA to €STR, many financial contracts by member states still remained. The European Commission, with concern about the volume of contracts yet to transition and to avoid disruptions to the market proposed that a replacement for EONIA to be designated in all references to the benchmark in any contract or financial instrument not already containing fallback provisions or does not contain suitable fallback provisions. In the regulation it is noted that €STR (as published by the European Central Bank - ECB) is the designated replacement rate for EONIA and that a fixed spread of 8.5 basis points will be added to the replacement rate (€STR), which was originally calculated by the ECB as the one-off spread between EONIA and €STR and help avoid value transfer during transition.



## Our Perspective

### **FCA Consultation on Synthetic LIBOR Methodology**

The FCA consultation paper (that sought feedback by October 20<sup>th</sup>, 2021) outlines its requirements that the LIBOR benchmark administrators for the 1-, 3- and 6-month GBP and JPY LIBOR settings publish these settings under a “synthetic” methodology, based on risk-free rates for all of 2022. This move by the FCA is to help avoid disruption to legacy contracts that reference these three LIBOR settings for the two currencies. While the FCA is providing a “synthetic” rate framework for these LIBOR settings, market participants should not just rely on these new rates and should continue with active LIBOR transition in order to retain both economic and functional control over their contracts.

### **Statutory Replacement Rate for the EONIA Benchmark**

The European Commission, due to the volume of EONIA based contracts and financial instruments and to avoid market disruption, have adopted regulation so contracts and financial products that do not have appropriate fallback provisions will leverage the replacement rate of €STR. As the January 3, 2022 EONIA discontinuation date approaches, the European Commission has implemented a plan to help avoid market disruption that could have occurred given the large volume of contracts that have yet to transition away from EONIA. By implementing an 8.5 basis point spread, the European Commission has helped alleviate the potential value transfer from EONIA to €STR during transition.



## Regulatory Updates

### Summary of Alternative Reference Rate Committee (ARRC) Office Hours Q&A with David Bowman (The FRB)

This section represents a summary of the ARRC office hours Q&A with David Bowman from October 1, 2021 until October 31, 2021. 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:

#### *Supervisory Guidance around Futures*

- There are four carve-outs to allow banks to enter into new U.S. Dollar (USD) LIBOR contracts and futures are not outside the guidance. Futures are LIBOR contracts and would be covered by the rules, so the carve-outs would not apply except in potential specific instances.

#### *Protocols for No New LIBOR Issuance*

- There have been many conversations about protocols for swap dealers to confirm they are abiding by supervisory guidance against no new use of USD LIBOR. The spirit of the guidance is principles based – won't be able to provide specific answers to each situation. There will be an element of judgment in how banks setup their compliance regimes. No additional guidance for supervised entities has been provided.

#### *Chicago Mercantile Exchange (CME) 12M Term Secured Overnight Financing Rate (SOFR)*

- CME is requesting licensees to provide certain confidential information about volume and use. In the UK, the benchmark providers are required to provide estimates to FCA about the use of the different benchmarks. This way, FCA can determine if the benchmark is a critical benchmark. FCA is not interested in who is using the rate individually and CME is not providing that information. CME is requiring this information for the estimate.

#### *FCA Methodology to Determine Critical Benchmarks*

- In some non-linear products, one wouldn't just scrap LIBOR, but would also need to swap Intercontinental Exchange (ICE) USD LIBOR swap. That is something that the ARRC and the UK Working group have worked on to determine what kind of spread adjustment one would like to have. Cash compensation hasn't worked in most cases (e.g. Price Alignment Amount (PAA) discounting for London Clearing House (LCH) as it's hard to get collective action around cash compensation. The ARRC encourages firms to convert early, at an appropriate price.

#### *Term SOFR and Fallback Protocol*

- In light of recent developments with term SOFR few market participants have questioned whether the International Swaps and Derivatives Association (ISDA) is planning to adopt Term-SOFR for the Fallback Protocol. The ARRC Office hours clarified that this is not correct. The definitions will not change. ISDA is not going to adjust the protocol to fallback to term SOFR instead of compound SOFR in arrears.

#### *Meaning of New Use of LIBOR*

- There are continuous discussions on how to provide more information including individual agency guidance. VP Quarles gave a speech on how the guidance would work for loans. Informally, he said that anything that increases the amount of LIBOR risk (changes the existing contract to extend the term or increase the amount) would be a 'new contract'.

#### *The Fed's Quarterly Percentile Information for SOFR*

- The Federal Reserve Bank of NY releases a daily SOFR rate along with percentiles to provide transparency. Every day, they produce the SOFR rate itself (a volume weighted median – the 50th % tile of the distribution), a 1st, 25th, 75th, 99th percentile rate and volume of transactions. On a quarterly basis, they provide even more information, including 4 more percentiles (5%, 40%, 60%, and 95%) because on a daily basis it would make the tables too busy and most participants do not need this information daily.

## Regulatory Highlights

- The FCA is proposing the use of legacy synthetic GBP and JPY LIBOR in all contracts outside of derivatives. The consultation is available [here](#).
- The European Commission has adopted the regulation of the replacement of EONIA as part of their Commission Implementing Regulation (EU) 2021/1848. The initiative is available [here](#) and the Implementing Act is available [here](#).

## ARRC / FRB Updates

- The ARRC released a summary of its recommendations to date regarding spread-adjusted fallbacks for contracts referencing USD LIBOR. The report is available [here](#).
- The ARRC recommends acting now to slow USD LIBOR use between now and December 1 to be well-positioned to meet Supervisory Guidance by year-end. The statement is available [here](#).
- ARRC Announces the Sixth Event in its Series "The SOFR Symposium: The Final Year on October 26<sup>th</sup>, 2021". The information is available [here](#).
- The FRB published a joint statement on managing the LIBOR transition. The statement is available [here](#).

## ISDA Updates

- ISDA published the Loan Market Association (LMA)/ Loan Syndications and Trading Association (LSTA) hedging confirmation templates. The templates is available [here](#).
- ISDA published the July 2021 derivatives trading activity report for the EU, UK and US. The report is available [here](#).
- ISDA published the updated version of the ISDA Risk Free Rate (RFR) conventions and IBOR fallback product table. The report is available [here](#).
- ISDA published the ISDA-Clarus RFR Adoption Indicator for September. The report is available [here](#).

## Other News/ Useful Reading

- The Office of the Comptroller of the Currency (OCC) released an updated self-assessment tool for banks. The bulletin is available [here](#).
- "Long way to go on LIBOR transition as key deadline nears". The article is available [here](#).
- "Fed's Quarles says markets must be ready to stop using LIBOR". The article is available [here](#).
- "U.S. companies pick up adoption of LIBOR alternative SOFR". The article is available [here](#).
- "First leveraged loan tied only to SOFR". The article is available [here](#).
- "Leveraged loan market's first deal tied to SOFR is long overdue". The article is available [here](#).
- "Pricing loans with LIBOR heir looks simpler than market feared". The article is available [here](#).
- "LIBOR deadline prompts surge in Collateralized Loan Obligations (CLO) issuance". The article is available [here](#).
- "Two new SOFR loans launch as market tests LIBOR replacement rate". The article is available [here](#).
- "ARRC says next six weeks 'key window' for shift away from LIBOR". The article is available [here](#).
- "Commodity Futures Trading Commission's (CFTC's) interest rate benchmark reform subcommittee selects November 8, 2021 for SOFR first for non-linear derivatives". The press release is available [here](#).
- "Wall Street isn't quitting troubled LIBOR yet, even as new SOFR-linked debt heads for a record ahead of deadline". The article is available [here](#).
- "Fed-backed LIBOR replacement SOFR holds at lower level amid cash deluge, Treasuries volatility". The article is available [here](#).
- "What the Fed means by 'new' when it says no new LIBOR contracts". The article is available [here](#).
- "LIBOR transition to SOFR done for floating-rate-note issuance". The article is available [here](#).

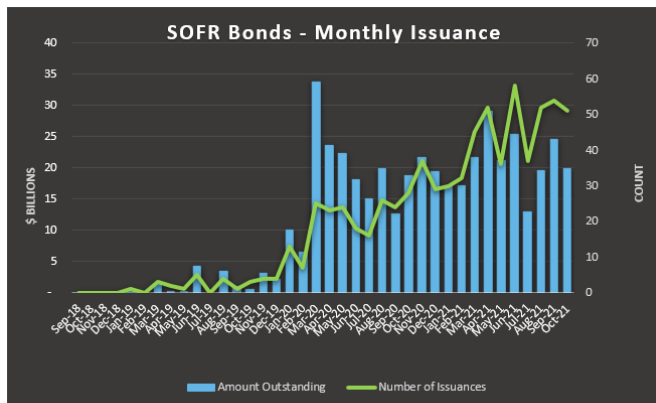


**Decrease in Debt Issuance Referenced to SOFR**

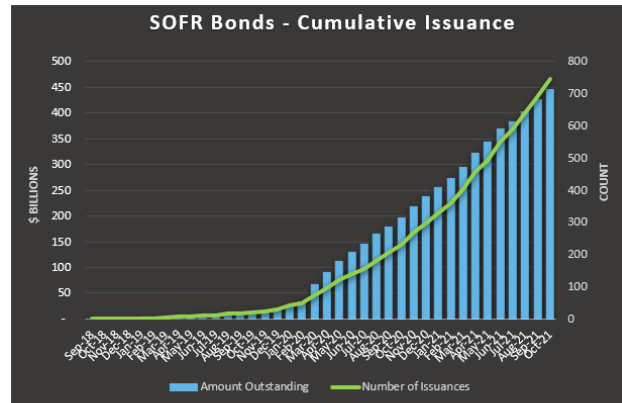
The issuance of SOFR referenced debt decreased in October 2021 compared to issuance in September 2021. The issuance size was \$19.9 billion in October 2021, which decreased from \$24.5 billion in September 2021. The graphs below represent data through October 2021.

The cumulative issue size of SOFR bonds outstanding (this excludes matured bonds) is currently \$456.4 billion with 767 bonds through November 17, 2021. There were 51 new issuances in October 2021 compared to 54 in September 2021 and 52 in August 2021.

In October 2021, federal agencies issued 25 SOFR referenced floating rate notes (FRN)'s worth \$6.7 billion. There were 26 issuances from other institutions which contributed \$13.2 billion to the outstanding amount of SOFR referenced debt.



Source: Reuters, compiled by Deloitte  
\*Data as of October 31, 2021

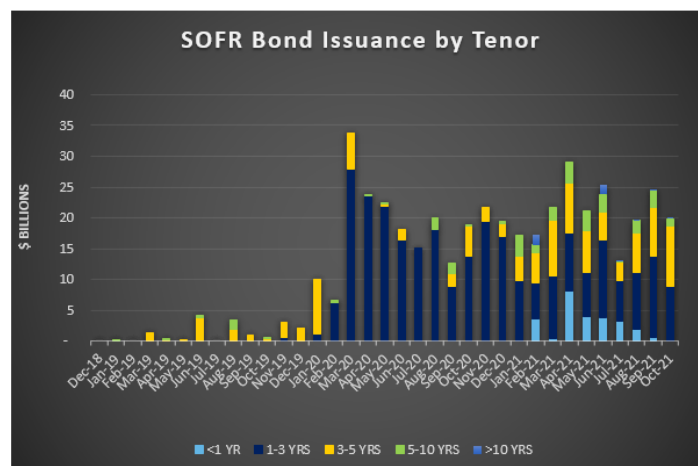


Source: Reuters, compiled by Deloitte  
\*Data as of October 31, 2021

**Increase in Longer Dated Debt Issuance (maturity 5-10 years) Referenced to SOFR**

SOFR debt issuances with a maturity greater than or equal to five years increased in October 2021 compared to September 2021. During October 2021, there were 12 bonds issued which have a maturity between five and 10 years, compared to 11 issuances in September 2021. There was 1 issuance during October 2021 that had a maturity greater than or equal to 10 years, as compared to 2 such issuances with a maturity greater than or equal to 10 years for September 2021.

There were 104 issuances of SOFR bonds outstanding worth \$35.5 billion, with a maturity greater than or equal to five years, through November 17, 2021 including 12 issuances worth \$3.4 billion with a term greater than or equal to 10 years.

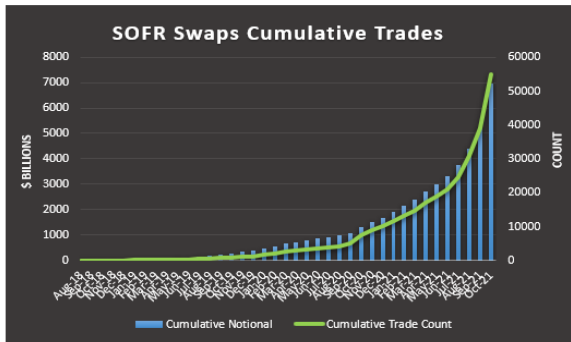


Source: Reuters, compiled by Deloitte  
\*Data as of October 31, 2021

## Cumulative SOFR Interest Rate Derivatives

### SOFR Swaps

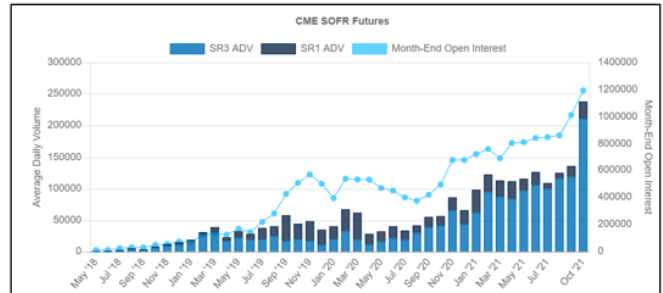
- The cumulative outstanding notional amount for SOFR based interest rate and basis swaps totaled \$6,965.3 billion through October 31, 2021.
- For the month of October 2021, the notional volume of SOFR-based interest rate and basis swaps totaled \$1,747.4 billion compared to \$833.3 billion in September 2021 and \$641.6 billion in August 2021.



Source: <http://swapsinfo.org/>, compiled by Deloitte  
 \*Data as of October 31, 2021

### SOFR Futures

- According to data available on CME, for October 2021, SOFR futures (including both 1-month and 3-month futures) average daily volume reached 238K contracts/ day. The data is available [here](#).
- The month-end open interest for SOFR 1-month and 3-month futures as of October 2021 was ~1.19M contracts.



Source: CME Group  
 \*Data as of October 31, 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 October 31, 2021.

Alternative Reference Rate	Swaps Cumulative notional amount (US \$ Billions)	Bonds Cumulative issuance amount (US \$ Billions)
SONIA	49,125.5	143.4
SARON	207.6	NA
TONAR	1,123.2	NA
€STR	999.3	5.6

Source: Reuters, <http://swapsinfo.org/>, compiled by Deloitte  
 Data as of October 31, 2021



## Global Highlights

### United Kingdom

- FCA issued a press release on further arrangements for the orderly wind-down of LIBOR at end-2021. The press release is available [here](#).
- FCA published a consultation "CP21/29: Proposed decisions on the use of LIBOR (Articles 23C and 21A BMR)". The consultation is available [here](#).
- FCA issued a Policy Statement 'PS21/13' on LIBOR transition and the derivatives trading obligation. The statement is available [here](#).
- "Synthetic LIBOR gets cautious approval as swaps fix". The article is available [here](#).
- "Synthetic LIBOR proposal would minimize near-term risk for UK Residential Mortgage Backed Securities (RMBS). The article is available [here](#).
- "UK watchdog sets out plans for a 'synthetic' LIBOR rate". The article is available [here](#).
- "New UK 'safe harbour' Bill introduced into Parliament". The article is available [here](#).
- "LIBOR and the FCA's new powers under the UK Benchmarks Regulation: questions and answers". The FAQ's are available [here](#).

### European Union

- A keynote speech from Futures Industry Association (FIA) International Derivatives Expo (IDX) conference was published regarding 'European Securities and Markets Authority (ESMA) priorities for derivatives'. The report is available [here](#).
- The Danish Working Group on Short-Term Reference Rate published a public consultation on transition from Tomorrow/Next (T/N) Rate to Denmark Short Term Rate (DESTR). The consultation is available [here](#).
- European Commission announced their initiative on the statutory replacement for Swiss Franc (CHF) LIBOR. The initiative is available [here](#) and the Implementing Act is available [here](#).
- "EONIA trading shuts down as Central Counterparties (CCPs) make €STR switch". The article is available [here](#).
- "Financial stability: Commission designates replacement rates for EONIA and CHF LIBOR". The article is available [here](#).

### Asia

- Bank Negara Malaysia announced the launch of a new RFR: the Malaysia Overnight Rate (MYOR). The statement is available [here](#).
- The Association of Banks in Singapore (ABS) updated FAQ's for customers regarding Singapore Swap Offered Rate (SOR) and Singapore Interbank Offered Rate (SIBOR) transition to Singapore Overnight Rates Average (SORA). The FAQ's are available [here](#).
- "The move from LIBOR and Transfer Pricing (TP) – a Thai perspective". The article is available [here](#).
- "Derivatives surge signals Singapore LIBOR shift is on track". The article is available [here](#).
- "Japan's LIBOR-linked structured products face basis menace". The article is available [here](#).
- "House of the year, Hong Kong: Crédit Agricole". The article is available [here](#).
- "SORA is a more robust interest rate benchmark than SOR and SIBOR". The article is available [here](#).
- "Japan dealers hail Tokyo Overnight Average Rate First ('TONA First') success". The article is available [here](#).



## Contact Us

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