ARRC
Alternative Reference Rates Committee | Newsletter

December 2020 - January 2021

This periodic newsletter provides an update for those with an interest in the work of the Alternative Reference Rates Committee (ARRC), keeping you well informed on key news relating to alternative reference rates transition in the U.S. and global markets.

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Top 3 Takeaways

1. **January 25, 2021 marked two critical transition milestones:**

   The International Swaps and Derivatives Association (ISDA) IBOR (interbank offered rates) Fallbacks Protocol and IBOR Fallbacks Supplement took effect.
   - The Protocol going into effect means that existing derivatives contracts will now incorporate ISDA's new fallbacks if both counterparties have adhered to the Protocol or otherwise bilaterally agreed to include the new fallbacks in their contracts.
   - The Supplement going into effect means that new derivatives contracts that incorporate the 2006 ISDA Definitions and reference a relevant IBOR will also incorporate the new fallbacks.

   The ICE Benchmark Administration (IBA) closed a consultation that it had released in December regarding its intention to cease the publication of LIBOR settings.
   - With respect to U.S. dollar (USD) LIBOR, that consultation included proposed end dates immediately following the December 31, 2021 publication for the minor LIBOR settings (1 Week and 2 Month) and immediately following the June 30, 2023 publication for major USD LIBOR settings (Overnight, and 1, 3, 6, and 12 Month).
   - As IBA has noted, *"After the feedback period has closed, IBA intends to share the results of the consultation with the FCA [Financial Conduct Authority] and to publish a feedback statement summarizing responses from the consultation shortly thereafter."*

2. **Governor Andrew Cuomo and New York State Budget Director Robert Mujica presented the Fiscal Year 2022 Executive Budget for the state on January 19, 2021 and included the ARRC's proposed New York LIBOR legislation.**
   - The inclusion in the Executive Budget marks an important step toward having the ARRC's legislative proposal passed and signed into law.
   - *See the "Other ARRC Developments" section below for additional legislation updates.*

3. **The ARRC released recommendations for new intercompany loans based on SOFR.**
   - As outlined in the document, the ARRC recommends that new Secured Overnight Financing Rate (SOFR)-based intercompany loans use the 30- or 90-day Average SOFR set in advance, with a monthly, quarterly, semi-annual, annual, or other reset period as is determined appropriate by the firm. 30- and 90-day Average SOFR incorporate several beneficial attributes that make these rates preferable to USD LIBOR.

Other ARRC Developments

- ARRC Chairman Tom Wipf authored a Bloomberg opinion-editorial, "Preparing for LIBOR's End Is Urgent," which explains the significance of late-2020 announcements by regulators and IBA on the proposed endgame for LIBOR. It also provides concrete advice to market participants on transitioning to SOFR, the ARRC's recommended alternative to USD LIBOR.
    - Wipf wrote that, "*Now that a proposed path is mapped out, the public and private sectors must work together with renewed urgency toward our common goal: preparing for no new Libor by transitioning all new activity to SOFR by the end of this year.*"
    - He also highlighted two key actions for market participants this year: *"immediately stop issuing USD Libor-based instruments and start writing SOFR into new contracts" and "protect any outstanding Libor contracts from uncertainty by amending them."*
- In addition to the ARRC's proposed legislation being included in Governor Cuomo's budget, other legislation-related developments include:
    - The ARRC posted an updated version of the proposal for New York State legislation, originally released on March 6, 2020. The proposal is intended to minimize legal uncertainty and adverse economic impacts associated with the LIBOR transition.
    - In December, a letter signed by several ARRC members, other firms, and associations was posted to the Securities Industry and Financial Markets Association (SIFMA) website, expressing support for the ARRC's draft legislative approach. The letter is addressed to New York State Governor Andrew Cuomo, Majority Leader Andrea Stewart-Cousins, and Speaker Carl Heastie. It notes that, *"many existing contracts either do not address a permanent end to LIBOR or have ambiguous fallback language that could dramatically alter the economics of hundreds of thousands of contracts. This legal uncertainty could create complex problems for parties or courts to sort out, and create great uncertainty in financial markets. Many of the financial products and agreements that reference LIBOR are governed by New York law. It is because of this, and New York's critical role in financial markets, that we urge your consideration of the Alternative Reference Rates Committee's legislative proposal."*
    - SIFMA issued a statement by its CEO Kenneth Bentsen Jr. in support of the letter from the ARRC regarding its LIBOR transition proposal for New York State legislation. It notes that, *"SIFMA fully supports and urges New York to pass" the legislation and that, "SIFMA is also discussing the issue with Congress to potentially enact federal legislation modeled on the New York law."*
- The ARRC updated its Frequently Asked Questions about the ARRC's work and the overall transition. The document was updated to reflect the alignment of the ARRC's Recommended Best Practices with the Q4 2020 announcements about USD LIBOR's endgame. In referring to the U.S. supervisory guidance, the document notes that *"the ARRC's Recommended Best Practices dates for no new issuances by product type were set with such a goal in mind. Given that, ARRC members concluded that its recommended guidelines are fully consistent with the timelines and message set out in the U.S. supervisory guidance and the IBA and FCA announcements."*
    - USD LIBOR's proposed endgame as well as details about what they mean for the ARRC's work and next steps are summarized in an ARRC guide. They are also covered in an ISDA webinar (recording and transcript), which brought together leadership from the ARRC, Federal Reserve, Financial Conduct Authority, and ISDA.

U.S. Developments

- In a speech delivered at SIFMA's LIBOR Transition Forum, Federal Reserve Bank of New York Senior Vice President Nathaniel Wuerffel discussed progress in the global effort to transition away from LIBOR, recent milestones in the U.S., and top priorities for 2021. He urged firms to transition as soon as possible, noting, *"I encourage you all to set New Year's LIBOR resolutions. And if you set only one for 2021 based on my remarks today, let it be this: No new LIBOR."*
- The Financial Accounting Standards Board made tentative decisions regarding the comment letter feedback received on its proposed Accounting Standards Update, Reference Rate Reform (Topic 848): Scope Refinement. The Board affirmed its decision to clarify the scope of Topic 848 with changes to improve clarity and operability, decided to provide additional optional relief to allow certain swaps to continue to qualify as eligible hedging instruments in net investment hedges and made an informed decision that the expected benefits would justify the expected costs of the amendments. As a next step, the Board directed staff to draft an Accounting Standards Update for vote by written ballot.

Market Developments

- CME Group released two reports on monthly market statistics. The January report highlighted SOFR futures average daily volume increased 91% from December 2019. The December report highlighted record SOFR futures average daily volume of 87,000 contracts. CME also reported a single-day volume record of 240,288 contracts on November 19 and a single-day open interest record of 682,931 contracts on November 30.
  - CME Group also released a consultation to consider transitioning existing IBOR swap exposures into new OIS contracts that follow RFR standards.
- ISDA hosted a video interview explaining why firms should update fallbacks in derivatives contracts. Katherine Tew Darras, ISDA's general counsel, explained some of the misperceptions regarding ISDA's IBOR Fallbacks Supplement and Protocol.
- The Financial Stability Board published its Work Programme for 2021, noting that it will continue to support transition away from LIBOR to more robust benchmarks by end-2021 and report on progress to the G20.

International Developments

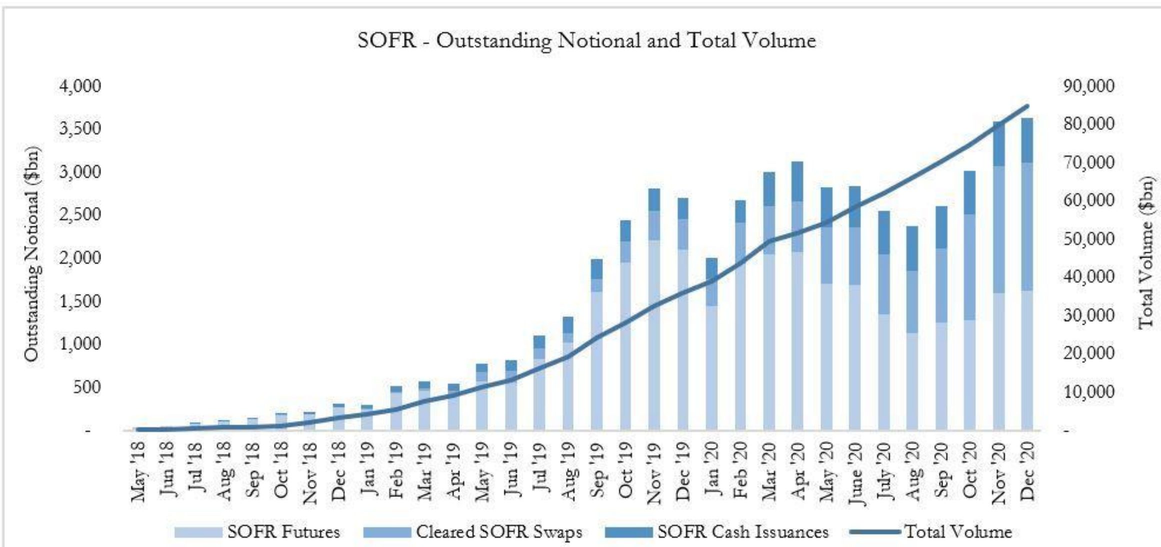
For more details on international efforts for reference rate reform, see the working groups in the U.K., Switzerland, Japan, Hong Kong the euro area, and the Official Sector Steering Group.

- Bank of England Executive Director for Markets Andrew Hauser delivered a speech at the Risk.net LIBOR telethon regarding what businesses and lenders need to do to be ready for LIBOR transition. He highlighted three key actions for market participants throughout the next year: (i) offer non-LIBOR products for new transactions, (ii) adopt the ISDA fallbacks for existing derivatives and (3) convert legacy contracts to another rate before the end of 2021 to reduce post-2021 LIBOR-linked contracts.
- The Working Group on Sterling Risk-Free Reference Rates (RFRWG) published an update to its priorities and roadmap for the final year of transition to help businesses finish planning the steps they will need to take in the coming months. The RFRWG's top priority is for markets and their users to be fully prepared for the end of sterling LIBOR by end-2021. In particular, it recommended that, "from the end of March 2021, sterling LIBOR is no longer used in any new lending or other cash products that mature after the end of 2021."
  - In conjunction with this, the Bank of England, FCA, and RFRWG issued a statement titled "The final countdown: Completing sterling LIBOR transition by end-2021." In addition to highlighting the RFRWG's priorities, the statement notes that, *"The Bank of England and the FCA have set out clear expectations for regulated firms to remove their reliance on LIBOR in all new business and in legacy contracts, where feasible. The primary way for market participants to have certainty over the economic terms of their contracts is to actively transition them away from LIBOR."* It also notes that *"Senior managers with responsibility for the transition should expect close supervisory engagement on how they are ensuring their firm's progress relative to industry milestones."*
- At a Swiss National Bank (SNB) news conference, SNB Governing Board member Andréa Maechler spoke about the "final sprint" in the transition from Swiss franc LIBOR to Swiss Average Rate Overnight (SARON). She noted the importance of transitioning to SARON as early as possible, including implementing robust fallbacks if LIBOR-based contracts cannot be switched to SARON before the end of 2021. By the end of 2021, the SNB will have no outstanding LIBOR-based derivatives in its investment portfolio and will exclude all LIBOR-based floating-rate notes from the list of collateral eligible for SNB repos when implementing monetary policy.
- Swiss Financial Market Supervisory Authority (FINMA), Switzerland's independent financial markets regulator, published a transition roadmap for LIBOR. FINMA recommends that affected supervised institutions follow this roadmap to prepare for the discontinuation of LIBOR.
- The Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks Sub-Group on Loans reported on the results of its Tokyo Overnight Average Rate (TONAR) consultation. Almost all members of the sub-group preferred the "Lookback without Observation Shift" approach for TONAR in Arrears conventions to use in loans.

- The Working Group on Euro Risk-Free Rates hosted its third roundtable with stakeholders from the private financial, non-financial sectors and public sector. The working group members discussed the public consultations on EURIBOR fallback trigger events and €STR-based EURIBOR fallback rates launched in November. Summaries of the consultations feedback will be published on the ECB's website and considered by the Working Group on Euro Risk-Free Rates during its February 18 meeting.
- The Association of Banks in Singapore, the Singapore Foreign Exchange Market Committee and the Steering Committee for SOR (Singapore Dollar Swap Offer Rate) and the Singapore Interbank Offered Rate (SIBOR) Transition to Singapore Overnight Rate Average (SORA) released their responses to the feedback received on the SIBOR Reform and the Future Landscape for SGD Interest Rate Benchmarks report published on July 29. The joint industry response noted the respondents' broad support for the proposed SIBOR discontinuation and timelines. They also supported the proposal to discontinue 6-month SIBOR before the other tenors, as well as to shift towards a SORA-centered interest rate market. In connection with this, the Committees also published timelines for the discontinuation of SIBOR by the end of 2024.

SOFR Market Liquidity

Since SOFR's initial publication in April 2018, approximately $889bn notional in floating rate instruments tied to SOFR have been issued, with over $519bn outstanding notional at December month-end.



As of December 31, 2020

Source: Bloomberg, CME Group, LCH, ICE

Note: Cleared SOFR swaps figures represent one side of each transaction (single-sided)

This newsletter is compiled by the ARRC's Outreach and Communications Working Group. If you have any questions please email the ARRC Secretariat at *arrc@ny.frb.org*.

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