The Alternative Reference Rates Committee

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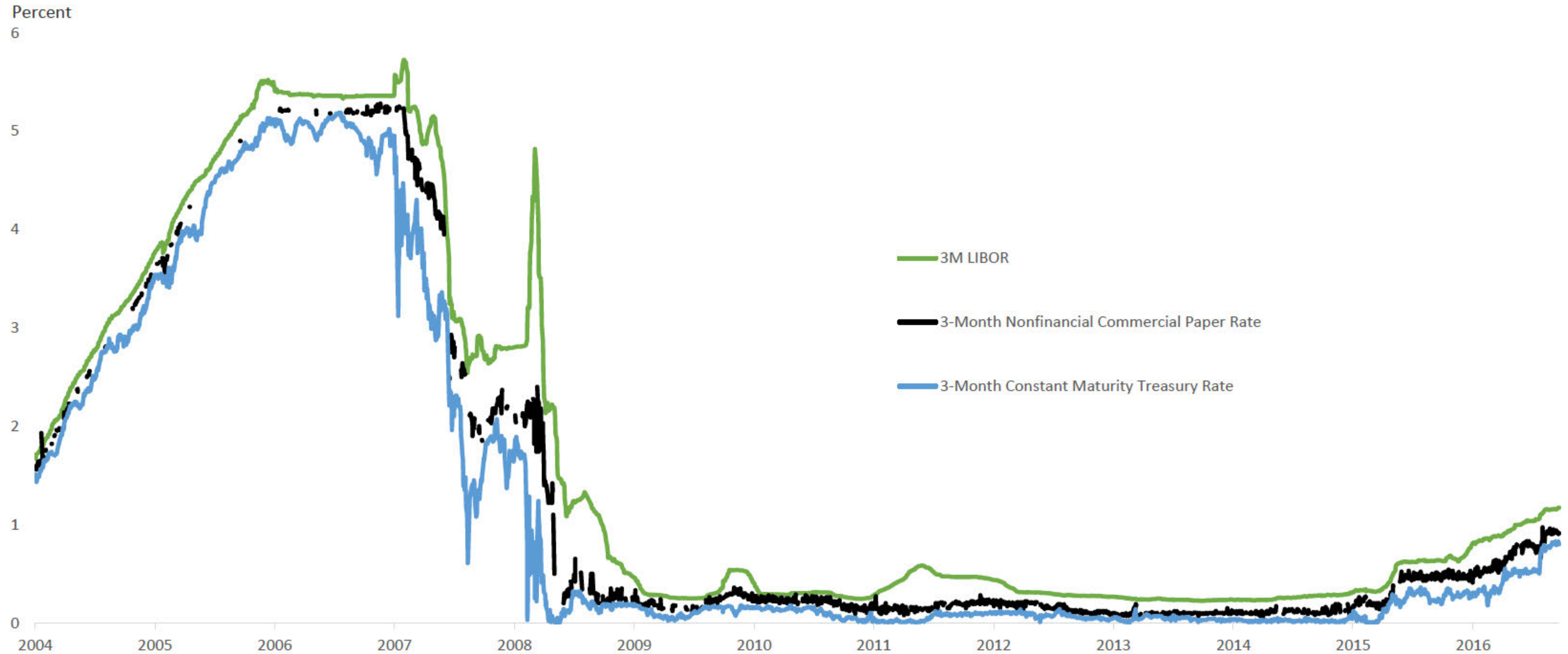
Evaluation Criteria for Potential Alternative Reference Rates

- **Benchmark Quality:** The degree to which the benchmark design ensures the integrity and continuity of the rate. The underlying market was evaluated according to its liquidity, transaction volume, and resilience.
- **Methodological Quality:** The degree to which the benchmark construction could satisfy the IOSCO Principles for soundness and robustness, including standardized terms, transparency of data, and availability of historic data.
- **Accountability:** Evidence of a process that ensures compliance with the IOSCO Principles.
- **Governance:** Evidence of governance structures that promote the integrity of the benchmark.
- **Ease of Implementation:** Assessed ease of transitioning to the rate, including:
  - Anticipated demand for and relevance to hedging/trading
  - Existence of, or potential for a term market in the underlying rate

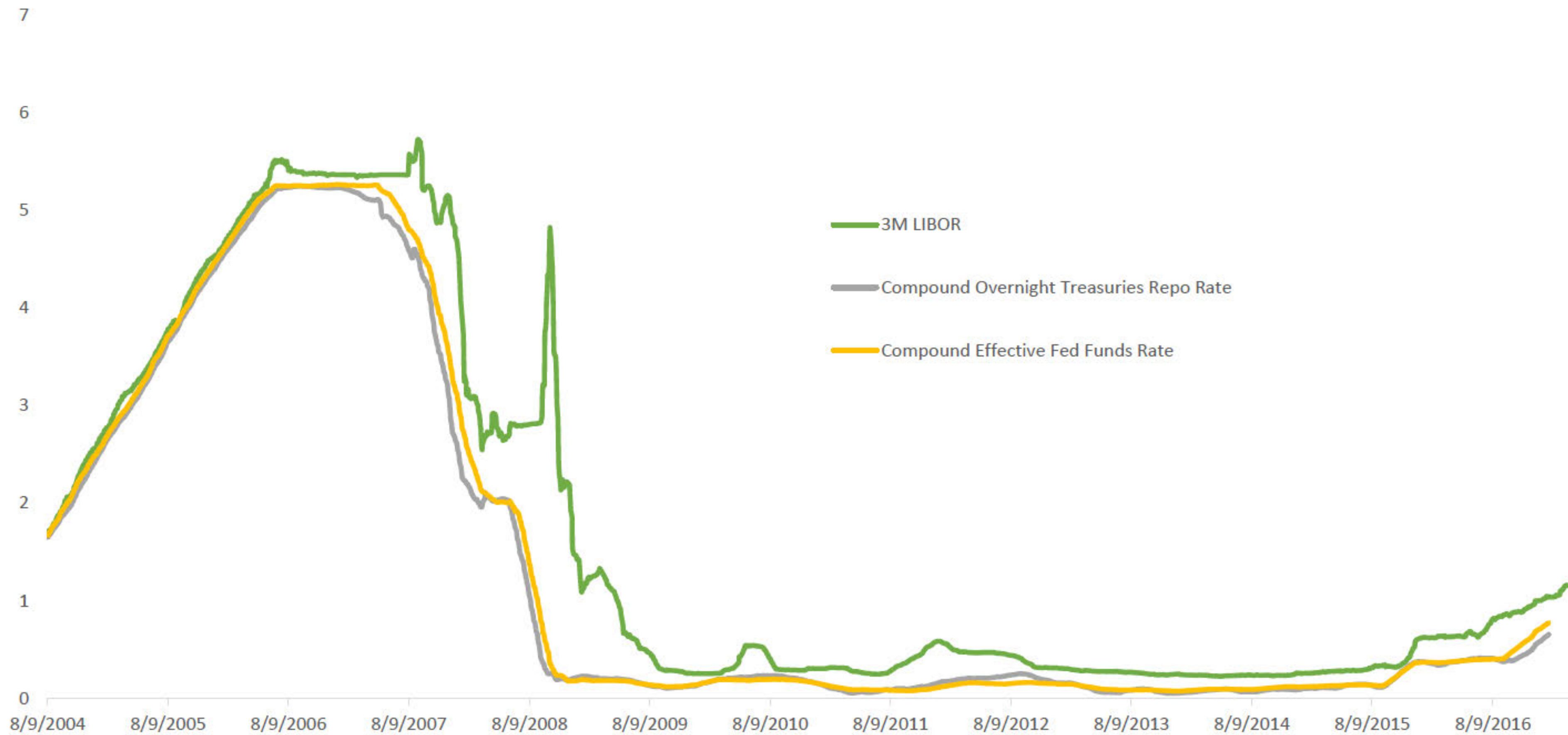
The Range of Rates Considered

- Overnight unsecured lending rates – the EFFR or the OBFR
- Overnight secured repo rates
- Policy rates – the Fed Funds target, the interest on excess reserves (IOER) rate, and the rate paid on overnight reverse repurchase (RRP) agreements
- Term unsecured lending rates
- Term OIS rates
- Treasury bill or bond rates

Treasury Rates versus Nonfinancial and Financial Borrowing Costs



Average Overnight Secured and Unsecured Rates are Similar



The Paced Transition Plan

1. Infrastructure for futures and/or OIS trading in the new rate is put in place by ARRC members.

   Anticipated completion: 2018 H2

2. Trading begins in futures and/or bilateral, uncleared, OIS that reference SOFR.

   Anticipated completion: by end 2018

3. Trading begins in cleared OIS that reference SOFR in the current (EFFR) PAI and discounting environment.

   Anticipated completion: 2019 Q1

4. CCPs begin allowing market participants a choice between clearing new or modified swap contracts (swaps paying floating legs benchmarked to EFFR, LIBOR, and SOFR) into the current PAI/discounting environment or one that uses SOFR for PAI and discounting.

   Anticipated completion: 2020 Q1

5. CCPs no longer accept new swap contracts for clearing with EFFR as PAI and discounting except for the purpose of closing out or reducing outstanding risk in legacy contracts that use EFFR as PAI and discount rate. Existing contracts using EFFR as PAI and the discount rate continue to exist in the same pool, but would roll off over time as they mature or are closed out.

   Anticipated completion: 2021 Q2

6. Creation of a term reference rate based on SOFR-derivatives markets once liquidity has developed sufficiently to produce a robust rate.

   Anticipated completion: by end of 2021

Questions Submitted to the ARRC

1. A recent Bank of America Merrill Lynch survey of 164 respondents (mostly asset managers and banks) reveals that an overwhelming majority feel that an improved version of LIBOR should continue alongside a risk-free reference rate alternative. What is the ARRC's opinion of LIBOR continuing alongside of SOFR?

2. What do you see as the two or three biggest challenges during the transition to the new benchmark?

3. Is there a plan to follow the "big bang" approach of SARON?

4. Would we expect universal adoption of the new index by the end of 2021?

5. When Bank Lending to Corporates start pricing off of the new Secured Overnight Financing Rate (SOFR) the all-in interest rate will likely decrease but the banks cost of funding will not. Will this lead to a write-down across the industry or will Lenders/Borrowers have to renegotiate all of these Loan spreads/margins?

6. It seems the 3 replacement indices being recommended by the ARRC are very similar and are all funding rates for assets rather than pure asset yields. Is there a concern that (1) these 3 alternatives are essentially the same as viewed by main street and (2) are all examples of funding rates, which means that they are heavily impacted by the large banks at month-end /quarter-end just as rate-setting are being established in contracts. This could result in perception of misalignment between wall street and main street all over again. These 2 attributes together may have the effect of confidence market participants will have for this product.

7. Is ARRC interfacing with ISDA to understand the work being completed both in the US and outside of the US regarding fallbacks to LIBOR within contracts and the debate over which party will determine the replacement benchmark and possibly the credit spread?