LIBOR Transition

Market update: January 1-31, 2022

514 days to June 20, 2023

1 Highlights

Knock knock, who's there? LIBOR dealer polls

What happened? The International Capital Market Services Association (ICMSA) issued a bulletin on synthetic LIBOR fallbacks and dealer poll mechanisms, supporting initiatives to clarify when panel banks would — or would not — be in a position to respond to such polls. While likely only applicable in a small number of contracts that cannot reference synthetic LIBOR — or have maturities expected to outlive synthetic LIBOR publication — the ICMSA says several members have advocated that such dealer polls be abolished through legislative action.

Citing comments by the Financial Conduct Authority's (FCA's) Edwin Schooling Latter, the ICMSA suggests that there is wide agreement that "the use of dealer poll mechanisms to obtain quotes for LIBOR-based rates is not appropriate or practicable in circumstances where the relevant LIBOR settings are no longer published." However, as there may be situations in which a dealer poll is needed to fulfill a contractual agreement, ICMSA's members strongly support efforts to develop regulatory guidance that could provide more clarity on the issue.

Our take: The issue of dealer polls is unlikely to be the last one in what is bound to be a series of nuanced operational issues that will arise as the transition continues. The question of how — or if — to respond to such a potential dealer poll is only a part of the issue here. On the other hand, administrative agents might wonder what exactly their obligations are with respect to attempting dealer polls that are contractually required under existing fallbacks. Even if they receive no response at the first reset date when the fallback becomes applicable, could they conceivably be required to attempt the same — likely futile — poll at every future reset date until the contract matures?

In this specific case, legislative solutions to address tough legacy exposures put in place in the European Union and the US provide a somewhat more elegant solution to the problem. Here, the legislations' mechanism effectively invalidates any fallback based on LIBOR, which explicitly includes dealer polls.

As has long been the case in matters involving contractual language, firms will need to have a detailed understanding of the provisions contained in their contracts. It's not clear that additional regulatory guidance, or even legislation, is forthcoming on the topic. But in case it does, there will likely be a need to refresh that analysis of contractual provisions.

As reset dates come and go, other operational challenges are likely to arise. The issue of dealer polls serves as a reminder that LIBOR transition programs will likely require ongoing support and resources — even for LIBOR currencies that are past their cessation date. Maintaining channels of communication, managing interaction with industry groups and retaining available resources to address ad hoc issues will allow firms to address issues as they arise over the following months.

C-ya-la-DOR part II: Consultation on CDOR's potential cessation

What happened? Refinitiv Benchmark Services Limited (RBSL) published a consultation regarding the potential cessation of the remaining tenors of the Canadian Dollar Offered Rate (CDOR). The consultation follows a recent white paper from the Canadian Alternative Reference Rate (CARR) working group that recommended ceasing the publication of CDOR after June 30, 2024.

RBSL is seeking feedback on potential issues that may arise from CDOR's cessation, as well as any concerns regarding the cessation date. Additionally, market participants are encouraged to provide feedback on whether alternatives to CDOR adequately cover all use cases, as well as on CARR's proposed two-staged approach to transition from CDOR. In its white paper, the working group suggested that derivatives and securities should transition to CORRA, its recommended alternative to CDOR, by June 2023, before completing the transition for remaining exposures in time for the actual cessation date.

Responses are requested by February 28, 2022.

Our take: Things will likely move quickly from here on out. When the ICE Benchmark Administration (IBA) consulted on the cessation of LIBOR in December 2020, a formal announcement on the benchmark's cessation followed just over a month after the close of that consultation. Similarly, following the close of Refinitiv's consultation, market participants should be prepared for an announcement on CDOR's cessation in a relatively short period of time.

Assuming that CARR's proposed timeline is adopted, we're now just 17 months away from the target date to complete the transition in derivatives. ISDA's IBOR Fallbacks protocol, which covers CDOR, should go a long way in facilitating that transaction. Achieving a second June 2023 milestone might prove a much more complicated undertaking: ending the use of CDOR in new cash products. CORRA, the recommended alternative to CDOR, is used only sparingly outside the derivatives market at this time.

Abandoning the use of CDOR in cash products might create challenges related to the potential development and evaluation of new alternative benchmarks, required infrastructure changes and the education of customers surrounding the change in rates. If the sometimes glacial transition from USD LIBOR to SOFR in USD cash markets is any indication, Canadian institutions appear to have a monumental task ahead of them.

As was the case for LIBOR, the forthcoming formal announcement on CDOR's cessation will trigger the calculation — and lock — of the credit spread adjustment according to ISDA's IBOR Fallbacks. In the case of USD LIBOR — given the ultra low rate environment we are in — fixing that spread resulted in a spread adjustment that was, and continues to be, significantly larger than the spot spread between USD LIBOR and SOFR. That difference has complicated the pricing of loans tied to SOFR, as lenders and borrowers sought to strike a middle ground between today's narrow spreads and the larger spreads expected to be applied by means of fallbacks at the time of USD LIBOR's eventual cessation. Given a similar rate environment, Canadian cash markets will face some of the same challenges. At the same time, US markets should provide some indication or guidance toward possible solutions.

RBSL's consultation will be the only public consultation prior to a formal decision on CDOR's cessation. For any market participants that are managing substantial exposures or foreseeing significant problems, now is the time to speak up.

One lesson learned from the transition in other currencies comes in the number of changes that various industry bodies and the public sector have made in response to industry commentary. With plenty of untouched ground around every corner, consultations on benchmark reform issues have arguably resulted in a greater number of changes when compared to consultations on other topics.

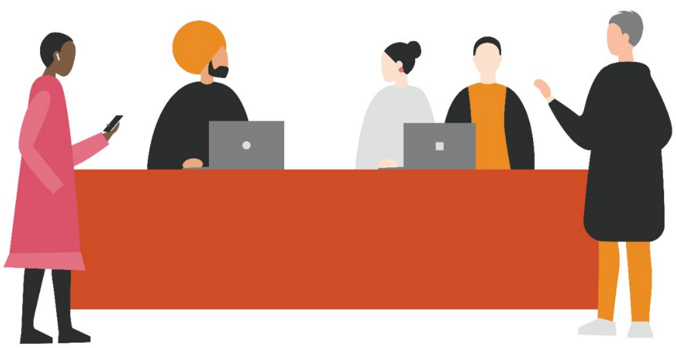
USD LIBOR swaps trading

What happened? The shift from USD LIBOR to SOFR in the derivatives market has accelerated sharply. ISDA reported that trade counts in SOFR swaps eclipsed those of USD LIBOR for the very first time in January. During the week ending January 28, trading volumes in SOFR swaps were close to 25% higher than those in USD LIBOR.

While trading volumes have been consistently higher in SOFR-based swaps, notional amounts have remained higher for USD LIBOR. Over the course of the same week, the total notional traded in USD LIBOR swaps was more than twice that traded in SOFR swaps.

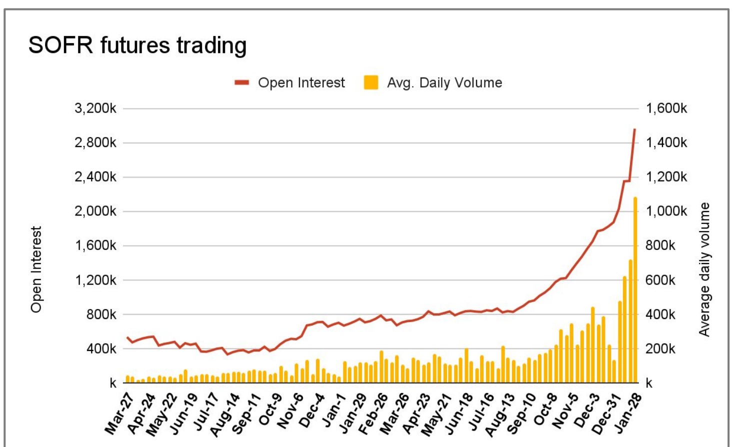
Our take: An increase in USD LIBOR trade sizes amid decreased trade volumes could indicate a shift in the user base. While end users continue to make the shift into SOFR swaps, there seemingly continues to be an ongoing need for macro hedges in USD LIBOR.

Over time, trading in USD LIBOR swaps should see a shift to institutional dealers employing dynamic hedges and large financial institutions managing portfolio hedges. As we near the cessation date, reduced activity may lead to wider bid-offer spreads. As a result, the costs of managing LIBOR risks in existing portfolios will in all likelihood increase for anyone still seeking to do so directly.

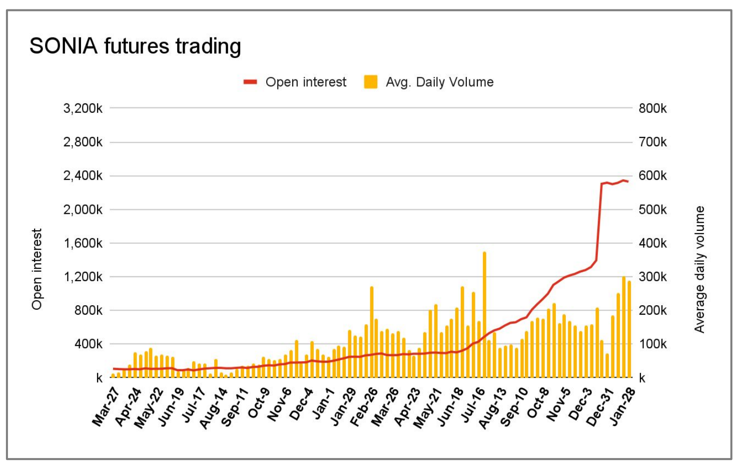


2 RFR adoption: Derivatives

Futures



Source: CME, ICE (accessed January 31, 2022)



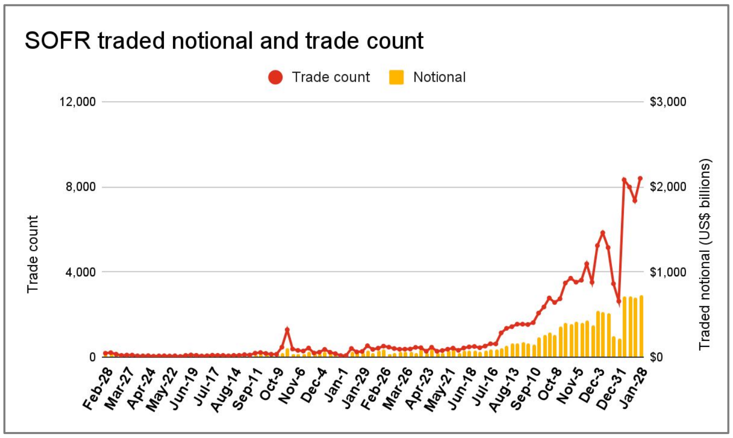
Source: CME, LCH, ICE (accessed January 31, 2022)

Our take

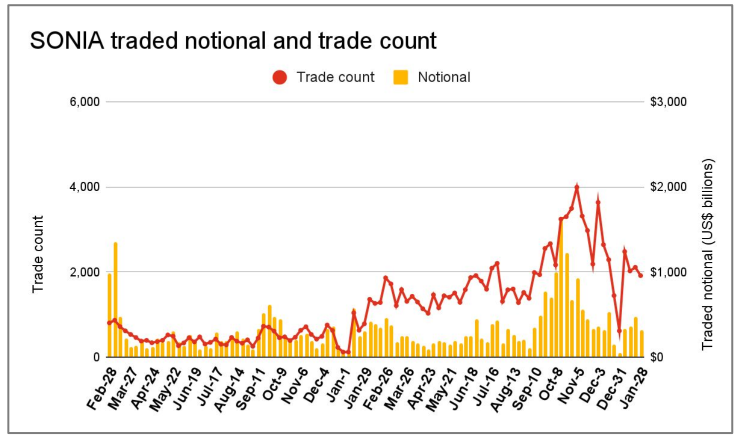
The CME announced new record volumes in SOFR futures trading, as average daily trading volumes have now eclipsed 1MM contracts. As anticipated, the first four weeks of January saw a steep rise in both volumes and open interest, which has effectively doubled since the end of November.

Following the publication of this issue, we will cease tracking SONIA futures trading, as the shift from GBP LIBOR to SONIA has effectively been completed in derivatives markets.

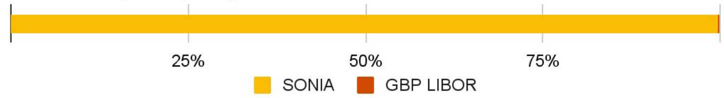
Swaps trading

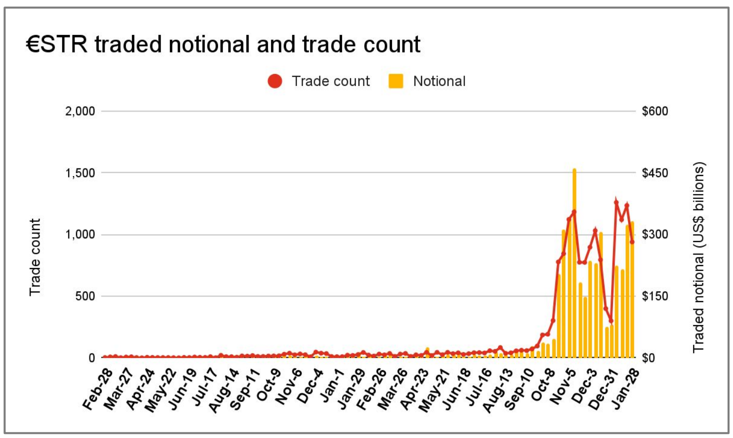


Total Notional (January 2022) - SOFR vs. USD LIBOR

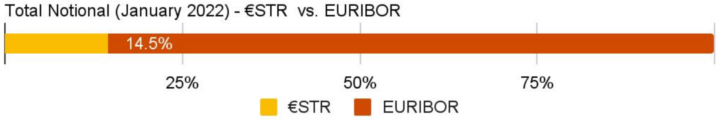


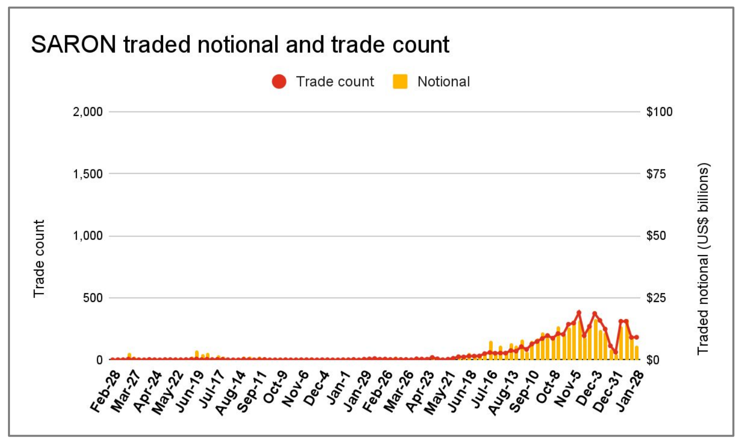
Total Notional (January 2022) - SONIA vs. GBP LIBOR



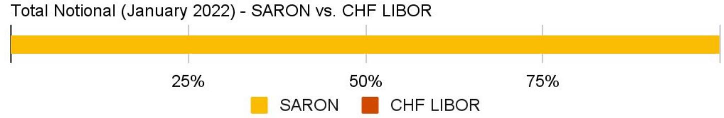


Total Notional (January 2022) - €STR vs. EURIBOR





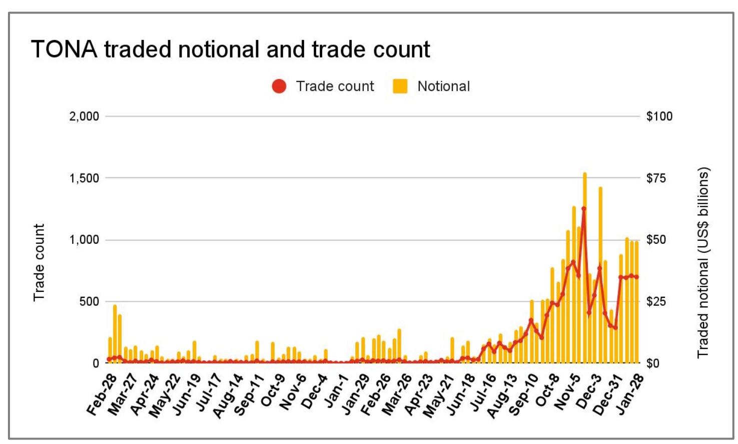
Total Notional (January 2022) - SARON vs. CHF LIBOR



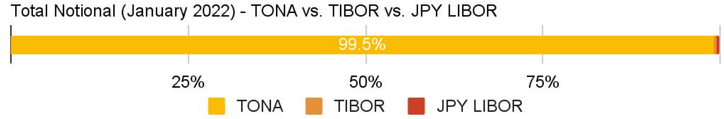
Our take

With this issue, we say goodbye to the charts tracking trading volumes in swaps based on SONIA, SARON and TONA. In these markets, the shift to RFRs has effectively been completed.

Beginning with our next issue, we will instead look to track the interplay between the increasing SOFR volumes and the anticipated decline in USD LIBOR swap trading activity.



Total Notional (January 2022) - TONA vs. TIBOR vs. JPY LIBOR



Source: analysis.swapsinfo.org (interest rate and credit derivatives weekly trading volume): Week ending January 28, 2022, accessed January 31, 2022

3 Publications at a glance

National working groups

Alternative Reference Rates Committee (ARRC)

- Released its newsletter for December 2021 - January 2022.

Working Group on Sterling Risk-Free Rates

- Published its newsletter for December 2021.
- Published an updated version of its roadmap for the transition away from LIBOR.

Working Group on Euro Risk-Free Rates

- Published minutes of the working group's December 3 meeting.

Cross-Industry Committee on JPY IR Benchmarks

- Published meeting materials from the committee's January 11 meeting, which included a summary of survey results on the transition away from JPY LIBOR as of the end of November 2021.
- At its January 31 meeting, the committee reviewed updated results of the same survey. As of December 21, surveyed institutions indicated that upward of 97% of all legacy contracts had been remediated.
- Published minutes from the committee's January 11 meeting.

Regulators

- **European Commission:** Launched initiatives to designate statutory replacements for GBP and JPY LIBOR. Draft regulations are expected to be available in the near future, with regulations expected to be finalized later in Q1 2022.
- **ESMA:** Updated its BMR Q&A document.
- Assumed its new role as supervisor of benchmark administrators and Chair of the EURIBOR college.
- **US Department of the Treasury:** Published an additional OFAC FAQ, noting that loans modified as part of the transition away from LIBOR would not be considered new debt in the context of certain sanctions programs.
- **Fed:** Reminded institutions to ensure that collateral pledged at the discount window continues to meet eligibility requirements.
- **OCC:** Asked the Office of Management and Budget (OMB) to extend its approval of the OCC's LIBOR Self-Assessment.
- **State of Florida:** Legislation to address legacy LIBOR exposures — similar to what was passed in New York State — was introduced in the Florida House and Senate.
- **National Bank of Serbia:** Issued recommendations for the replacement of CHF LIBOR and EONIA in Serbian markets (in Serbian).

Industry groups, infrastructure providers and other items

- **ISDA (w/ EMTA):** Issued recommended market practices for the incorporation of SOFR as RFR into Latin American currency non-deliverable cross-currency swap transactions.
  Published the ISDA-Clarus RFR Adoption Indicator for December 2021, which increased to 31.7% (up from 26.3% in November).
  Published its recurring research note reviewing the transition to RFRs over the full year 2021 and Q4 2021, specifically.
  Updated its guidance on the cessation of the GBP LIBOR ICE Swap Rate.
  Published its response to the CFTC's consultation on swap-clearing requirements.
  Confirmed that Refinitiv's consultation on the potential cessation of CDOR did not constitute a benchmark cessation event.
- **LSTA:** Published a summary of recent IRS tax guidance on LIBOR transition, prepared by external counsel (member access required).
  Published a blog post discussing lending in a SOFR world.
  Published a blog post on the transition from LIBOR in CLOs.
- **LMA:** Published a compounded TONA schedule, a French language version of the respective RFR facility agreement and an updated RFR destination table (member access only).
  Reminded market participants of CME Term SOFR licensing requirements.
- **International Capital Market Services Association:** The ICMSA issued a bulletin on synthetic LIBOR fallbacks and dealer poll mechanisms, supporting initiatives to clarify when panel banks would — or would not — be in a position to respond to such polls.
- **LIBOR Trade Association Working Party:** Published minutes from the group's December 1 meeting.
- **UK Finance:** Announced it would wind down its LIBOR transition project.
- **CME:** Updated its FAQs on Term SOFR.
- Announced that open interest in SOFR futures has now surpassed 2.8 million contracts.
- **Refinitv:** Launched a consultation on the potential cessation of the Canadian Dollar Offered Rate (CDOR).
  As administrator of the TIBOR swap rate, issued a consultation paper initially proposing to cease publication of the rate as early as January 31, 2022. A majority of respondents requested the continued publication of the rate. As a result, Refinitiv will continue to publish the rate, albeit under a modified methodology effective February 1, 2022.
- **SOFR Academy:** Published a populated version of the OCC's latest LIBOR Self-Assessment Tool, containing draft guidance and considerations for referencing the Across-the-Curve Credit Spread Indices (AXI).
- **Investment Company Institute:** In its response to the CFTC's consultation on swap clearing requirements, the ICI suggested liquidity in RFR linked swaps should be allowed to grow organically and autonomously.
- **National Association of Federally Insured Credit Unions:** Published a blog post summarizing the CFPB's final rule on Reg Z amendments related to the transition away from LIBOR.
- **Bankers Association for Finance and Trade:** BAFT provided perspectives on the transition from LIBOR in the trade finance markets.

4 LIBOR transition target dates

December 31, 2021
End of publication/loss of representativeness:
GBP, EUR, JPY, CHF LIBOR and 1W, 2M USD LIBOR
US Supervisors/FCA/FSB/FINMA: no new USD LIBOR products

2022

Early 2022
EMMI/IBA: €STR term rate

End of 2022
FCA: Review of necessity to renew decision to compel publication of synthetic GBP LIBOR

2023

December 31, 2022
End of publication:
1-, 3- and 6-month synthetic JPY LIBOR

June 2023 (Dates TBA)
CCPs: preemptive transition of legacy USD LIBOR trades to SOFR

June 30, 2023
End of publication/loss of representativeness:
o/n, 1-, 3-, 6- and 12-month USD LIBOR

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