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September 20, 2019

Recent Developments Concerning LIBOR and Benchmark Reform Transition

[31975]

September 20, 2019 TO: ICI Members
Investment Company Directors
ICI Global Members
Derivatives Markets Advisory Committee
Fixed-Income Advisory Committee
Municipal Securities Advisory Committee SUBJECTS: Derivatives
Disclosure
Fixed Income Securities
Fund Accounting & Financial Reporting
International/Global
Investment Advisers
Municipal Securities
Operations
Trading and Markets RE: Recent Developments Concerning LIBOR and Benchmark Reform Transition

We wanted to let you know about a few recent developments concerning LIBOR discontinuation and benchmark reform transition.

First, the Alternative Reference Rates Committee (ARRC) recently released a "Practical Implementation Checklist" for market participants to consider in transitioning from US dollar LIBOR to the Secured Overnight Financing Rate (SOFR) as a reference rate.[1] The checklist covers a number of key functions within firms, such as governance, communications, risk management, and operational readiness. While the checklist is focused on banking institutions, the information in the checklist may be helpful for other market participants to review and modify according to their size and volume of LIBOR exposures, among other factors.

The ARRC also updated its Frequently Asked Questions, which discuss common industry questions regarding the transition from US dollar LIBOR to SOFR.[2] The Frequently Asked Questions now address the potential for overnight SOFR to be volatile on a day-to-day basis. The ARRC states "it is important to remember that contracts referencing SOFR have been based on averages of these daily rates" and the "averages of SOFR have been quite smooth."

Separately, the CFTC's Market Risk Advisory Committee (MRAC) recently approved "plain English" examples of disclosures addressing LIBOR transition. The MRAC recommends firms consider these disclosures in connection with new derivatives issuances that continue to reference LIBOR.[3] The MRAC anticipates the plain English disclosures will be helpful models that firms can amend as needed to use with counterparties and clients in explaining the implications of transactions that reference LIBOR. The MRAC submitted the disclosures to the CFTC for their consideration.[4]

Finally, ISDA issued a new consultation on the "final parameters" for the spread adjustments that would apply to fallback rates if certain interbank overnight rates (IBORs), such as LIBOR, are permanently discontinued. Respondents to two earlier consultations[5] preferred the "compounded setting in arrears" rate to address the difference in tenors between IBORs and risk-free reference rates (*e.g.*, SOFR). Respondents also preferred the "historical mean/median approach" to address the difference in risks between those types of rates.[6] The currently open consultation requests comment from respondents on technical follow up issues regarding the specific calculation of the spread adjustments. The deadline to submit comments on ISDA's consultation is October 23. ICI is not planning to comment on this consultation but encourages member firms to comment directly if you have feedback to provide.

For your reference, we have included links below to some helpful US resources on benchmark reform issues:

- **Securities and Exchange Commission:** Staff Statement on LIBOR Transition: https://www.sec.gov/news/public-statement/libor-transition
- **Alternative Reference Rates Committee (ARRC):** Transition from LIBOR https://www.newyorkfed.org/arrc/sofr-transition and Fallback Contract Language https://www.newyorkfed.org/arrc/fallbacks-contract-language
- **ISDA:** Resources on benchmark reform: https://www.isda.org/category/legal/benchmarks/

LIBOR discontinuation and benchmark transition for asset managers also will be a topic of focus at the upcoming ICI Securities Law Developments Conference on December 3, 2019. The conference program and registration materials are available at https://www.ici.org/seclaw/.

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endnotes

[1] *See Alternative Reference Rates Committee Practical Implementation Checklist for SOFR Adoption* (Sept. 2019), *available at* https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/ARRC-SOFR-Checklist-20190919.pdf.

[2] *See Alternative Reference Rates Committee Frequently Asked Questions* (updated Sept. 19, 2019), *available at* https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/ARRC-faq.pdf.

[3] *See CFTC Market Risk Advisory Committee Approves Plain English Disclosures at Public Meeting* (Sept. 13, 2019), *available at* https://www.cftc.gov/PressRoom/PressReleases/8011-19; *see also Supplement to the "Plain English" Disclosures for Derivatives Referencing LIBOR and other IBORs* (Sept. 10, 2019), *available at* https://www.isda.org/2019/09/10/supplement-to-the-plain-english-disclosures-for-derivatives-referencing-libor-and-other-ibors/.

[4] Members may also recall that the SEC staff issued a statement on LIBOR transition in July that also recommended that funds and advisers consider making disclosures to investors about the consequences of the discontinuation of LIBOR. *See Staff Statement on LIBOR Transition* (Jul. 12, 2019), *available at* https://www.sec.gov/news/public-statement/libor-transition. *See also* ICI Memorandum No. 31855 (Jul. 15, 2019) for a summary of the SEC staff statement.

[5] *See Summary of Responses to the ISDA Supplemental Consultation on Spread and Term Adjustment* (Sept. 18, 2019), *available at* https://www.isda.org/a/BV0TE/2019.09.18-ISDA-Supplemental-Consultation-Report-by-The-Brattle-Group.pdf; *Anonymized Narrative Summary of Responses to the ISDA Consultation on Term Fixings and Spread Adjustment Methodologies* (Dec. 20, 2018), *available at* http://assets.isda.org/media/04d213b6/db0b0fd7-pdf/. *See also* ICI Memorandum No. 31885 (Aug. 2, 2019) for an overview of the previous ISDA consultation.

[6] The compounded setting in arrears rate is the relevant risk-free reference rates observed over a period of time that is generally equivalent to the relevant IBOR tenor (*e.g.*, 3 months for 3-month USD LIBOR) and compounded daily during that period.

The historical mean/median approach to the spread adjustment is based on the mean or median spot spread between the IBOR and the adjusted risk-free reference rate calculated over a static lookback period prior to the relevant announcement or publication triggering the fallback provisions.