

**MEMO# 32252**

February 27, 2020

# **LIBOR Update: ARRC Consultation on Swaptions and ISDA Consultation on Pre-Cessation Fallback Language**

[32252]

February 27, 2020 TO: Accounting/Treasurers Committee  
Derivatives Markets Advisory Committee  
LIBOR Transition Working Group  
SEC Rules Committee  
Securities Operations Advisory Committee  
Security Valuation Operations Committee RE: LIBOR Update: ARRC Consultation on Swaptions and ISDA Consultation on Pre-Cessation Fallback Language

We wanted to alert you to recent activity from the Alternative Reference Rate Committee (ARRC) and ISDA concerning LIBOR transition.

## **I. ARRC Swaptions Consultation**

The ARRC issued a consultation regarding compensation methodologies for swaptions that will be impacted by the upcoming central counterparty (CCP) discounting transition.[\[1\]](#) As you may know, on October 16, 2020, the CCPs will change their discounting for USD-denominated interest rate swaps from the Effective Federal Funds Rate to SOFR. As part of the transition, the CCPs will provide a mechanism for the exchange of cash and/or risk compensation for differences in valuation resulting from the discounting.[\[2\]](#)

Swaptions with valuations based on the price of underlying cleared interest rate swaps also will be affected by the CCP discounting transition. However, the CCP compensation mechanism will not apply to these swaptions. Thus, the ARRC requests feedback on whether it should recommend:

- A voluntary exchange of cash compensation between counterparties of legacy swaption contracts, and
- Conventions for new swaption contracts traded before the October 16, 2020 CCP discounting transition date.

ICI is not planning to comment on this consultation but encourages member firms to comment directly if you have feedback to provide. ARRC has requested feedback by March 9, 2020.

## II. ISDA Pre-Cessation Consultation

ISDA issued a new consultation regarding potential “pre-cessation” fallback language.<sup>[3]</sup> The pre-cessation period is a potential time period in which LIBOR may continue to be published, but because fewer panel banks are submitting rates, the UK Financial Conduct Authority would no longer consider LIBOR to be representative.

In 2019, ISDA conducted a consultation on potential fallback language for derivatives contracts regarding the pre-cessation period.<sup>[4]</sup> Responses to the consultation indicated that a majority of market participants generally would not want to continue referencing LIBOR (or other IBORs) in existing or new derivatives contracts following a statement that those rates were no longer representative. Respondents, however, did not reach a consensus on how to respond to such a statement in fallback language.

In light of new information that ISDA has received from the UK Financial Conduct Authority and the ICE Benchmark Administrator regarding the expected pre-cessation period,<sup>[5]</sup> ISDA has opened a new consultation. The new consultation asks whether ISDA should provide fallback language that would apply to all covered derivatives following the permanent cessation of an IBOR or a pre-cessation event, whichever occurs first.

ISDA is requesting feedback by March 25, 2020. ICI is not planning to comment on this consultation but encourages member firms to comment directly if you have feedback to provide.

In addition to this consultation, ISDA also recently issued a white paper reviewing the milestones expected in 2020 relating to LIBOR transition.<sup>[6]</sup>

Bridget Farrell  
Assistant General Counsel

### endnotes

<sup>[1]</sup> Available at [https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC\\_Swaption\\_Consultation.pdf](https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Swaption_Consultation.pdf).

<sup>[2]</sup> See LCH Proposed next steps for transition to USD SOFR discounting in SwapClear, available at [https://www.cftc.gov/media/3221/MRAC\\_LCH\\_SOFRDiscountingLetter121119/download](https://www.cftc.gov/media/3221/MRAC_LCH_SOFRDiscountingLetter121119/download); CME Group SOFR Discounting and Price Alignment Transition Plan for Cleared USD Interest Rate Swaps, available at <https://www.cmegroup.com/education/articles-and-reports/sofr-price-alignment-and-discounting-proposal.html>.

<sup>[3]</sup> See ICI Memorandum No. 32177 regarding recent UK Financial Conduct Authority statements regarding pre-cessation LIBOR, available at [https://www.ici.org/my\\_ici/memorandum/memo32177](https://www.ici.org/my_ici/memorandum/memo32177).

<sup>[4]</sup> See Anonymized Narrative Summary of Responses to the ISDA Pre-Cessation Consultation (Oct. 21, 2019), available at

<http://assets.isda.org/media/e0b1bac2/04397355-pdf/>.

[5] See ICI Memorandum No. 32177, *supra* note 3.

[6] See ISDA Research Note: Adoption of Risk-Free Rates: Major Developments in 2020, *available at*

<https://www.isda.org/a/WhXTE/Adoption-of-Risk-Free-Rates-Major-Developments-in-2020.pdf>.

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