



SOFR So Good – The Final Days of LIBOR

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J.P.Morgan

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2023 marks the last step on the LIBOR transition journey. Five U.S. dollar (USD) LIBOR settings (Overnight, 1-, 3-, 6- and 12-month) continue to be calculated using panel bank submissions until June 30, 2023¹. With the cessation deadline for USD LIBOR only weeks away, all the key puzzle pieces necessary for a successful industry-wide transition to Secured Overnight Financing Rate (SOFR) appear to be in place. As we enter the final stretch, market participants should consider the impact of recent developments and continue to execute their plans for cessation.



Regulatory Developments

In the last five months, the final two pieces of rulemaking for the transition from USD LIBOR to SOFR were published. Together they significantly reduce uncertainty and provide a clear process for replacing USD LIBOR in existing contracts following its anticipated discontinuance on June 30, 2023.

- ❖ **December 16, 2022** - The Federal Reserve Board adopted² a final rule that implements the Adjustable Interest Rate (LIBOR) Act (the LIBOR Act). The LIBOR Act identifies benchmark rates based on the SOFR that will replace USD LIBOR in certain financial contracts after the cessation of USD LIBOR on June 30, 2023. The scope of this federal legislation covers contracts that are governed by U.S. law only. The following contracts are considered in scope: contracts that lack any fallback provisions, contracts whose fallback provisions lead to a replacement rate that is itself based on LIBOR, and contracts that require polling for interbank rates. The LIBOR Act also includes an optional safe harbor for contracts that permit or require the selection of a replacement rate by a nominated party and also clarifies who would be considered a “determining person” able to choose to use the replacement benchmark rate selected by the Fed for use for certain LIBOR contracts. The selected benchmark rates are as follows:
 - ❖ Derivatives: Fallback Rate (SOFR) which includes the applicable spread
 - ❖ Cash Products: Contracts that reference overnight LIBOR will go to daily SOFR and all others to CME Term SOFR plus spread adjustment. Cash transactions involving entities regulated by the Federal Housing Finance Agency and Federal Family Education Loan Program Asset Backed Securities will go to 30-day Average SOFR
 - ❖ Federal Home Loan Bank Advances: Fallback Rate (SOFR) which includes the applicable spread
- ❖ **April 3, 2023** - The U.K. Financial Conduct Authority (FCA) confirmed³ its decision to require LIBOR’s administrator, ICE Benchmark Administration® Limited (IBA), to continue to publish the 1-, 3- and 6-month USD LIBOR settings under an unrepresentative ‘synthetic’ methodology until end-September 2024. After this date, publication will cease permanently. All legacy contracts other than cleared derivatives would be permitted to use a synthetic USD LIBOR. Synthetic USD LIBOR would not be available for use in new contracts. The FCA are clear that synthetic USD LIBOR rates will not be representative of the market that LIBOR is intended to reflect. Therefore, any contract with

¹ Use of USD LIBOR for new business was restricted from end-2021, with limited exceptions. See U.S. Agencies statement <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201130a.htm>

² <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20221216a1.pdf>

³ <https://www.fca.org.uk/news/news-stories/fca-announces-decision-synthetic-us-dollar-libor>

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pre-cessation triggers or any contract under U.S. law covered by the LIBOR Act will fallback at end-June 2023 regardless of any publication of a synthetic LIBOR.

Governmental Bodies Guidance

In addition to distinct legislative actions, governmental bodies have continued to publish statements and/or guidance for an orderly transition from LIBOR. A few examples are provided below.

- ❖ December 16, 2022 - The Financial Stability Board (FSB) published⁴ a progress report on the transition from LIBOR and other benchmarks encouraging final transition to robust reference rates as cessation of remaining LIBOR panels approaches.
- ❖ March 15, 2023 - The Alternative Reference Rate Committee (ARRC) laid out⁵ its selections and recommendations, as a relevant governmental body, to be applied in 1-, 3-, 6-, and 12-month USD LIBOR legacy contracts to determine the Benchmark Replacement, the Benchmark Replacement Adjustment and the Recommended Replacement Index for closed-end residential adjustable-rate mortgages, floating rate notes, variable-rate private student loans, bilateral business loans, syndicated business loans, and securitizations.
- ❖ April 12, 2023 - The Bank of England and the FCA published⁶ a statement encouraging market participants to: actively transition USD LIBOR contracts ahead of the cessation of the USD LIBOR panel at end-June 2023; ensure readiness for implementation of USD LIBOR fallbacks, including planned central counterparties (CCP) conversion events and operationalization of the ISDA 2020 IBOR Fallbacks Protocol; ensure they transition to the most robust Risk Free Rates; and continue to actively transition any remaining legacy contracts from synthetic GBP LIBOR to Sterling Overnight Index Average (SONIA)⁷.
- ❖ April 26, 2023 - The Federal Reserve Board, Consumer Financial Protection Bureau, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency and state bank and credit union regulators released⁸ a joint statement on completing the LIBOR transition.
- ❖ April 27, 2023 - The FSB issued⁹ a statement to encourage market participants to prepare their legacy contracts for the USD LIBOR transition at the end of June 2023 to avoid market disruption.

Industry Solutions

Due to the significant volume of debt securities transitioning from USD LIBOR, the industry identified the need for an efficient, systematic approach to effectively communicate those changes to all parties involved. Through close collaboration across the industry led by the ARRC and Depository Trust & Clearing Corporation (DTCC), this critical gap has been filled with the launch of the DTCC LIBOR Replacement Index Communication Tool (the Tool). Market participants are able to access the solution through DTCC's Legal Notice System (LENS), a repository of notices designed to report organizational actions that affect securities issues from issuers, agents, and trustees, as well as through an automated data feed that will support machine-to-machine capture of standardized reference data. Approximately six thousand submissions have been communicated via the Tool since it went live on February 24, 2023. The majority of submissions have been on 3-month TERM SOFR¹⁰.

⁴ <https://www.fsb.org/2022/12/fsb-encourages-final-transition-to-robust-reference-rates-as-cessation-of-remaining-libor-panels-approaches/>

⁵ <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2023/ARRC-statement-on-1-3-6-12-month-USD-LIBOR.pdf>

⁶ <https://www.fca.org.uk/news/news-stories/usd-libor-panel-ceases-end-june-2023-are-you-ready>

⁷ Publication of 1- and 6-month synthetic GBP LIBOR ceased at end-March 2023 and 3-month synthetic GBP LIBOR will cease at end-March 2024.

⁸ <https://www.occ.gov/news-issuances/bulletins/2023/bulletin-2023-13a.pdf>

⁹ <https://www.fsb.org/2023/04/fsb-statement-to-encourage-final-preparations-for-the-usd-libor-transition/>

¹⁰ As reported in April 2023 by the ARRC Operations/Infrastructure Working Group

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What clients can expect from J.P. Morgan Securities Services

Third-party market reference data vendors will subscribe to the DTCC solution, collect the updated rate and terms data and make the same available to the J.P. Morgan Fund Accounting service as part of the existing data files we receive. Fund Accounting will apply these new rates to income calculations as of the effective date of the rate change.

While the DTCC solution was a critical initiative and a significant undertaking and accomplishment, it is relevant to note that the information provided by issuers, agents and determining persons is done on a voluntary basis. To track that rate change information is received for impacted debt securities, J.P. Morgan will create an inventory of securities and based on the expected rate change date post the June 2023 cessation date will monitor the inventory to confirm that rate changes are received as and when expected.

Derivative and Loan Transition Plans

Cleared OTC Derivatives – CCPs, LCH Ltd (LCH) and the Chicago Mercantile Exchange (CME) Group, have confirmed their plans to convert outstanding cleared USD LIBOR derivative contracts into corresponding SOFR-based contracts over multiple dates in Q2 of 2023.

❖ CME

- ❖ **How?** CME will convert to a new forward-starting SOFR swap (i.e., same fixed rate as original contract versus SOFR + fallback spread), with any remaining LIBOR-linked cashflows booked as a short-dated swap. A cash compensation will be applied as an upfront fee to the SOFR replacement swap.
- ❖ **What and When?**
 - April 21, 2023: Primary conversion date (all USD LIBOR products excluding zero coupon swaps)
 - July 3, 2023: Second run (zero coupon swaps and any remaining USD LIBOR swaps)

❖ LCH

- ❖ **How?** LCH will convert each LIBOR swap into a SOFR swap (+ fallback spread) with the exact same dates (and fixed rate) as the old swap. A basis swap “overlay” trade will then be booked for the final LIBOR payments. The cash compensation will be delivered to participants via an upfront fee on a new \$1 notional swap.
- ❖ **What and When?**
 - April 21, 2023: Tranche 1 USD LIBOR conversion for USD LIBOR vs Fed Funds Basis swaps, USD LIBOR VNS and USD LIBOR Zero Coupon swaps
 - May 19, 2023: Tranche 2 USD LIBOR conversion for USD LIBOR vs Fixed IRS, USD LIBOR vs USD LIBOR Basis swaps, USD LIBOR vs USD SOFR OIC Compound Basis swaps

Non-Cleared OTC Derivatives and Loans - As of January 2022, the market was no longer permitted to use USD LIBOR in new loans or derivative contracts per regulatory guidance. Since that time, it was anticipated that loan market participants would focus on their legacy population of facilities that reference USD LIBOR, and the remediation of these by means of (i) refinance, (ii) amendment to modify the interest rate provisions from LIBOR to alternative benchmark, or (iii) amendments to agreements where there is no defined LIBOR fallback mechanic to a defined benchmark (i.e., ARRC hardwired fallback). To the extent possible, counterparties of non-cleared OTC derivatives were expected to remediate and/or liquidate their remaining USD LIBOR positions.

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Cleared OTC Derivatives - In preparation for the transition events, J.P. Morgan identified impacted client positions and assessed the operational requirements and considerations pertaining to the transition. We have been engaging with clients on a one-to-one basis to review our planned approach as well as to review client requirements related to the overall operational treatment with specific focus on the handling of cash compensation amounts and conversion fees.

Non-cleared derivatives - Similar to the preparation activities leading up to non-USD LIBOR cessation, J.P. Morgan has designed and developed a systemic solution to fallback impacted contracts. We have notified clients with impacted positions that unless otherwise instructed, we will apply the relevant terms of the ISDA IBOR Fallback Protocol¹¹ to any USD LIBOR-linked trade still held on June 30, 2023.

Loans - For legacy loan positions, Securities Services has supported and will continue to support the repapering of deals and the rate re-fixes as directed.

Other IBORs

Over the past months we have continued to witness increased focus from the industry on the transition of other IBORs. A few key IBOR transitions are noted below.

Tokyo Interbank Offered Rate (TIBOR) - Refinitiv ceased publication of Tokyo Swap Rate for swaps referencing TIBOR on March 31st, 2023

Canadian Dollar Offered Rate (CDOR) - On May 16, 2022, Refinitiv Benchmark Services (UK) Limited (RBSL), the designated benchmark administrator for CDOR announced that CDOR will cease to be published after a final publication on Friday, June 28, 2024. The Ontario Securities Commission and the Autorité des marchés financiers, as co-lead authorities for RBSL and CDOR, authorized the cessation. CDOR will be discontinued over a two-stage transition period - the first stage would run until the end of June 2023, and the second stage would run until the end of June 2024. It is expected that market participants will use the Canadian Overnight Repo Rate Average (CORRA) as the alternative rate for most instruments that currently reference CDOR. See CSA Staff Notice 25-309 Matters Relating to Cessation of CDOR and Expected Cessation of Bankers' Acceptances¹² for additional information about the current progress of the Canadian Alternative Reference Rate working group (CARR) to develop a suitable benchmark replacement rate for CDOR.

¹¹ See April 13, 2023 International Swaps and Derivatives Association (ISDA) webinar, USD LIBOR Final Steps, where, among other topics, ISDA reviews the detail of the IBOR Fallbacks https://assets.isda.org/media/isda-webinar-usd-libor-final-steps/?_zs=Mdn3G1&_zl=cdR57

¹² <https://www.osc.ca/en/securities-law/instruments-rules-policies/2/25-309/csa-staff-notice-25-309-matters-relating-cessation-cdor-and-expected-cessation-bankers-acceptances>



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USD LIBOR ICE Swap Rate - On November 14, 2022, IBA¹³ announced that it will cease the publication of all USD LIBOR ICE Swap Rate “runs” (i.e., USD LIBOR Rates 1100, USD LIBOR Spreads 1100 and USD LIBOR 1500) for all tenors immediately after publication on June 30, 2023. On April 13th, 2023, IBA announced¹⁴ that following market feedback, the USD SOFR Spread-Adjusted ICE Swap Rate will be available for use as a benchmark in financial contracts and instruments from June 30, 2023.

¹³ <https://ir.theice.com/press/news-details/2022/ICE-Benchmark-Administration-Publishes-Feedback-Statement-on-the-Consultation-on-the-Potential-Cessation-of-ICE-Swap-Rate-based-on-USD-LIBOR/default.aspx>

¹⁴ <https://ir.theice.com/press/news-details/2023/ICE-Benchmark-Administration-Provides-Update-on-its-Intention-to-Launch-USD-SOFR-Spread-Adjusted-ICE-Swap-Rate-as-a-Benchmark/default.aspx>

Contributors

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Dave Burfeind	J.P. Morgan Securities Services – Fund Accounting Product Manager
Chris Johnson	J.P. Morgan Securities Services – Complex Securities Product Manager
Michael Mykytiw	J.P. Morgan Securities Services – Global Regulatory Practice



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