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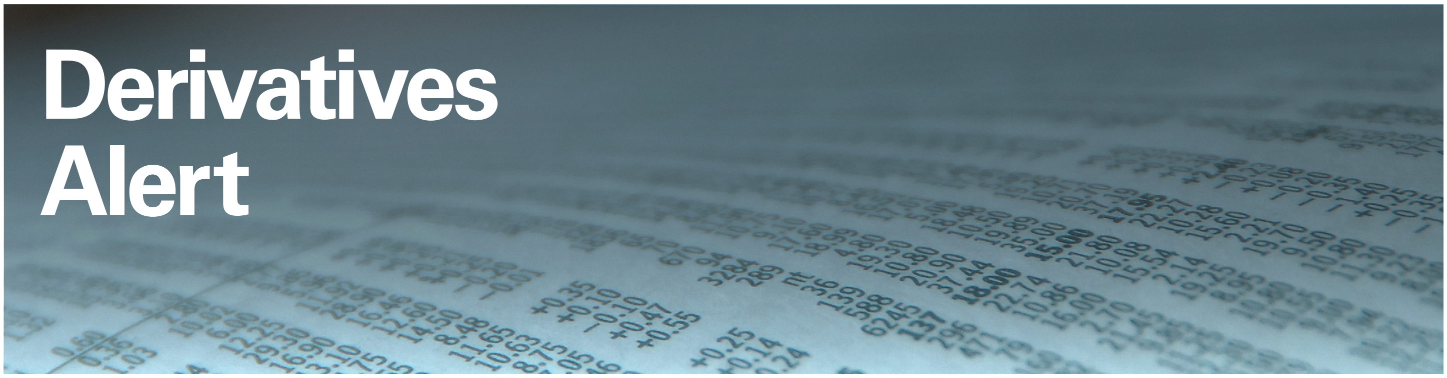
Derivatives Alert



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Federal Reserve Board Seeks Public Comment on Alternatives to LIBOR

The U.S. Federal Reserve Board is requesting public comment on proposed plans for the Federal Reserve Bank of New York and the Office of Financial Research to publish three new reference rates intended as alternatives to the London Interbank Offered Rate (LIBOR).[1] The rates are based on overnight repurchase agreement, or "repo," transactions collateralized by U.S. Treasury securities.[2] The proposed plans for new reference rates are tied to the recent regulatory interest in considering a transition from LIBOR to alternative rates for the many financial transactions, such as derivatives trades, mortgages and loans, that are now based on LIBOR.

One of the proposed new rates would be the Secured Overnight Financing Rate (SOFR), which would be based on tri-party repo[3] data from the Bank of New York Mellon and cleared bilateral[4] and general collateral finance (GCF) repo[5] data from the Depository Trust & Clearing Corporation (DTCC). SOFR is the rate recently recommended by the Alternative Reference Rates Committee, a working group of banks convened in 2014 by

[1] *See* Press Release, "Federal Reserve Board Requests Public Comment on Proposal to Produce Three New Reference Rates Based on Overnight Repurchase Agreement (Repo) Transactions Secured by Treasuries," Board of Governors of the Federal Reserve System (Aug. 24, 2017) [hereinafter "Federal Reserve Board Requests Public Comment"]. The Office of Financial Research, established by the Dodd-Frank Act, is an independent bureau within the U.S. Department of the Treasury that seeks to foster financial stability by measuring and assessing risks, conducting research, and gathering and standardizing financial data. *See* About the OFR, Office of Financial Research (last visited Aug. 25, 2017).

[2] *See* "Federal Reserve Board Requests Public Comment." Treasury repos involve the sale of a Treasury security (or portfolio of Treasury securities) and an agreement to repurchase the security or portfolio on a specified date and at a certain price. *See* Request for Information Relating to Production of Rates, Federal Reserve System, Docket No. OP-1573, at 3 (Aug. 24, 2017) [hereinafter "Request for Information"].

[3] A tri-party repo involves the use of a clearing bank to clear and settle the transaction by managing the securities and ensuring that they adhere to the eligibility requirements of the party providing cash in exchange for the securities. *See* "Request for Information" at 4-5.

[4] In bilateral repos, counterparties' custodians exchange cash and securities without a third-party intermediary to manage collateral and centralized settlement. *See id.* at 6-7.

[5] GCF Repo is a service introduced by DTCC subsidiary Fixed Income Clearing Corporation (FICC) that allows FICC netting members to trade cash and securities with one another pursuant to negotiated rates and terms. GCF Repo trades are made anonymously using interdealer brokers, and they settle on the clearing banks' tri-party repo platforms. FICC acts as the legal counterparty for each side of the trade for settlement purposes. *See id.* at 5-6. In a "general collateral" repo trade, the party providing cash stipulates a "general" portion of acceptable collateral that the party providing the Treasury securities must pledge but does not stipulate the specific securities that must be pledged. *Id.* at 3. In GCF Repo, FICC defines the population of collateral classes. *Id.* at 5.

the Federal Reserve Board and the Federal Reserve Bank of New York following the Financial Stability Oversight Council recommendation to identify an alternative benchmark to LIBOR.[6]

The other two rates are the Tri-Party General Collateral Rate (TGCR), which would be based on tri-party repo data from the Bank of New York Mellon, and the Broad General Collateral Rate (BGCR), which would be based on tri-party repo data from the Bank of New York Mellon and cleared GCF repo data from DTCC.[7]

The Federal Reserve Board noted that the new rates would be beneficial because, among other reasons, they are based on transactions secured by U.S. Treasury securities, which are "essentially risk-free"[8] and tied to a deep and liquid market.[9] By publishing the new rates, the Federal Reserve Board hopes to improve transparency in the repo market.[10] The Federal Reserve Board anticipates that the new rates will be published by mid-2018.[11]

For more information on regulators' plans to transition from LIBOR to alternative rates, and the potential resulting considerations for derivatives market participants, see Skadden's August 15, 2017, client alert. Comments to the rate proposals are due within 60 days of publication of the Federal Reserve Board's request in the Federal Register, which is anticipated shortly.[12]

[6] *See* "U.S. Fed Seeks Comments on Libor Alternatives," Reuters (Aug. 24, 2017) [hereinafter "U.S. Fed Seeks Comments"]; *see also* "Request for Information" at 9.

[7] *See* "U.S. Fed Seeks Comments"; "Request for Information" at 8.

[8] *See* "Federal Reserve Board Requests Public Comment."

[9] *See* "Request for Information" at 2.

[10] *See id.*

[11] *See id.*

[12] *See id.* at 1.

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