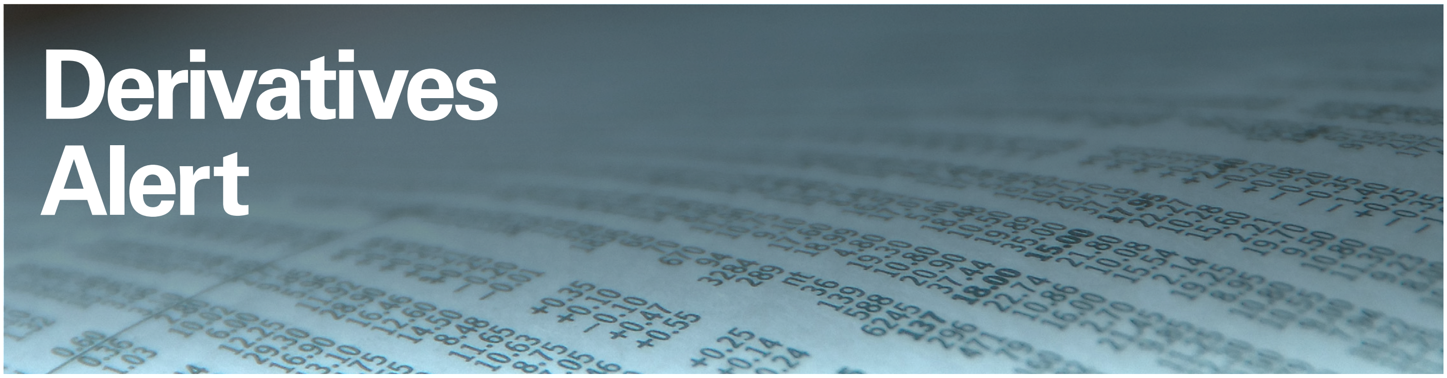
March 28, 2018

Skadden



Contacts

Mark D. Young
Partner / Washington, D.C.
202.371.7680
mark.d.young@skadden.com

Maureen A. Donley
Of Counsel / Washington, D.C.
202.371.7570
maureen.donley@skadden.com

Daniel B. O'Connell
Associate / Washington, D.C.
202.371.7003
daniel.oconnell@skadden.com

Four Times Square
New York, NY 10036
212.735.3000

1440 New York Avenue, N.W.
Washington, D.C. 20005
202.371.7000

Federal Reserve Gears Up to Publish LIBOR Alternative

On April 3, 2018, the Federal Reserve Bank of New York (FRBNY) will begin publishing three reference rates based on overnight repurchase agreement (repo) transactions collateralized by U.S. Treasury securities: the Secured Overnight Financing Rate (SOFR), Broad General Collateral Rate (BGCR) and Tri-Party General Collateral Rate (TGCR).[1] FRBNY originally announced in 2016 that it would be publishing the three new rates in conjunction with the Treasury Department's Office of Financial Research in order to "improve transparency of the repo market by increasing the amount and quality of information available about the market for overnight Treasury general collateral (GC) repo."[2] SOFR, BGCR and TGCR will be published daily at 8 a.m. EST.[3]

The three repo rates are calculated in an inter-related manner. TGCR will be based on tri-party repo data. BGCR will include TGCR source data plus Fixed Income Clearing Corporation (FICC) General Collateral Finance Repo data. SOFR will comprise BGCR source data as well as bilateral Treasury repo transactions cleared through FICC, giving it the "widest coverage of any Treasury repo rate available."[4]

SOFR was selected as the U.S. dollar alternative to the London Interbank Offered Rate (LIBOR) by the Alternative Reference Rates Committee (ARRC), a group of financial institutions, trade groups and regulators that the Board of Governors of the Federal Reserve System and FRBNY convened in 2014.[5] ARRC has noted that the benefits of

[1] "Statement Regarding the Initial Publication of Treasury Repo Reference Rates," Fed. Reserve Bank of N.Y. (Feb. 28, 2018) [hereinafter "FRBNY Statement"].

[2] *See* "Statement Regarding the Publication of Overnight Treasury GC Repo Rates," Fed. Reserve Bank of N.Y. (Nov. 4, 2016). *See also* "Production of Rates Based on Data for Repurchase Agreements," 82 Fed. Reg. 58,397 (Dec. 12, 2017) (announcing production of the new rates); "Request for Information Relating to Production of Rates," 82 Fed. Reg. 41,259 (Aug. 30, 2017) (requesting public comment on the production of the new rates).

[3] FRBNY Statement.

[4] "Second Report," ARRC, at 7 (Mar. 2018) [hereinafter "Second Report"]; Joshua Frost, "Introducing the Secured Overnight Financing Rate (SOFR)," ARRC, at 1 (Nov. 2, 2017) [hereinafter "Introducing SOFR"].

[5] *See* "The ARRC Selects a Broad Repo Rate as its Preferred Alternative Reference Rate," ARRC (June 22, 2017); "About Us," ARRC (last visited Mar. 27, 2018); "Governance," ARRC (last visited Mar. 27, 2018). The ARRC recently announced that it had expanded its membership so as to better coordinate with users of financial products other than derivatives, such as corporate loans and floating rate notes. *See* "Membership for ARRC Broadened to Facilitate LIBOR Transition," ARRC (Mar. 7, 2018); "The ARRC Will Be Reconstituted Next Year," ARRC (Nov. 27, 2017). ARRC's work to select an alternative to USD LIBOR is paralleled in other LIBOR-currency jurisdictions, as working groups in the United Kingdom, Japan and Switzerland have selected alternatives, and a group in the European Union has now been formed to do the same. *See* "IBOR Global Benchmark Survey: 2018 Transition Roadmap," ISDA (Feb. 2018), at 21 [hereinafter "Roadmap"]. Currently, the alternative Swiss Average Overnight Rate (SARON) and Tokyo Overnight Average Rate (TONA) are being published, while the U.K. Reformed Sterling Overnight Index Average (SONIA) rate is scheduled to begin publication on April 23, 2018. *Id.* at 32.

SOFR include its underlying market volume,[6] range of market coverage[7] and flexibility to account for market evolution.[8]

On July 27, 2017, Andrew Bailey, chief executive of the U.K. Financial Conduct Authority (FCA), LIBOR's regulator, announced that LIBOR would be transitioned to alternative rates by the end of 2021, after which the FCA would no longer compel or persuade banks to contribute to LIBOR.[9] For more on the LIBOR transition, see Skadden's August 28, 2017, and August 15, 2017, client alerts.

[6] *See* Second Report at 7 (noting that "the transactions underlying SOFR regularly exceeded $700 billion in daily volumes last year and have been growing").

[7] *See id.*

[8] *See* Introducing SOFR at 3.

[9] "The Future of LIBOR," FCA (July 27, 2017). The main issue underpinning the drive for a LIBOR alternative has been the dwindling number of transactions in the interbank markets underlying the rate. That has required banks that contribute to LIBOR to rely increasingly on judgment. The potential liability associated with such judgment-based submissions has given panel banks pause about continuing to submit to LIBOR. *See* Roadmap at 3-4.

The start of SOFR publication begins to set in motion the "Paced Transition Plan," a plan developed by the ARRC to accomplish a transition from LIBOR to alternative rates. The plan contemplates progressively building an active trading market in SOFR-based derivatives, culminating in the development of a term rate that could be used in contracts for cash products.[10] SOFR is only an overnight rate, while LIBOR is available in a variety of tenors, and the need for a term rate has been identified as just one of the challenges that a transition from LIBOR to alternative reference rates will present.[11] That transition will be an extended process involving numerous steps by financial market participants and regulators. Market participants should actively monitor the transition process and begin taking steps to prepare for a transition to alternative rates, including reviewing existing contracts to understand how a change in or discontinuation of LIBOR would affect those contracts.

[10] *See* Second Report at 17-24.

[11] *See* Roadmap at 26-30 (summarizing LIBOR transition challenges).