Invested in America

August 29, 2022

Submitted to: regs.comments@federalreserve.gov

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and
Constitution Avenue NW
Washington, DC 20551

Re: RIN 7100–AG34 / Docket No. R–1775 / Regulation Implementing the Adjustable Interest Rate (LIBOR) Act

Dear Ms. Misback,

SIFMA[1] is pleased to respond to the Federal Reserve Board's proposed rule ("Proposed Rule")[2] that would implement the Adjustable Interest Rate (LIBOR) Act ("the Act" or "statute").[3] SIFMA has long been a strong advocate for Federal legislation that provides clarity and a means for the transition of so-called tough legacy contracts to alternative benchmarks. We believe the Act is a tremendously important component of the finalization of the transition away from LIBOR. The Proposed Rule that implements the Act is similarly important, and we are pleased that the Proposed Rule generally tracks the legislation in a close manner. We do, however, have some conceptual and other more granular comments on the Proposed Rule, and discuss our views and suggestions below.

A. "Covered Contracts" and "Non-Covered Contracts"

The Proposed Rule creates a regulatory delineation between "covered contracts" and "non-covered contracts". We believe this is intended to categorize contracts with respect to the application of the regulation, but these terms do not appear in the statute, and the delineation does not exactly track the scope of the statute. We do not believe the delineation of covered vs. non-covered contracts is useful and instead has caused confusion among market participants.

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[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

[2] Board of Governors of the Federal Reserve System, "Regulation Implementing the Adjustable Interest Rate (LIBOR) Act" (July 28, 2022), available here: https://www.federalregister.gov/documents/2022/07/28/2022-15658/regulation-implementing-the-adjustable-interest-rate-libor-act

[3] Adjustable Interest Rate (LIBOR) Act, Public Law 117–103, div. U, section 102(a)(1).

For example, the definition of covered contract excludes a contract where a determining person has selected the Board-selected benchmark replacement prior to the benchmark replacement date. The regulation states that "This regulation does not affect LIBOR contracts that are not covered contracts."[4] However, the statute includes within its scope and impacts many kinds of LIBOR contracts, including the contracts discussed in this paragraph which the regulation calls "non-covered" and states it does not affect. Any gaps between the perceived application of this regulation and the application of the statute can only lead to confusion and inefficiency.

We suggest that the final rules should eliminate the concept of a covered or non-covered contract and instead more closely track the text and structure of the statute. In other words, the rules should begin with a definition of LIBOR contracts, and then discuss the provisions of the legislation applicable to them and the outcomes under this regulation, in a similar manner to how they are discussed in §104 of the statute. This would simplify the analysis of the regulation and the statute for market participants since they would track more closely, avoid confusion, and also allow the regulation to be drafted in a more concise manner.

B. Benchmark Replacement Clarifications Regarding Determining Persons

Consistent with the intent of the legislation, the final rule should clarify that in all cases where a contract falls within the scope of the LIBOR Act, the LIBOR-based benchmark used in the contract will be replaced no later than first reset following the LIBOR Replacement Date,[5] either (1) though the selection of a benchmark replacement by a determining person, or (2) by the operation of the Section 104(c)(3) of the statute on the replacement date, regardless of the reason a determining person has not selected a replacement rate.

Congressional intent was that all LIBOR-based benchmarks used by contracts within the scope of the Act be replaced by the LIBOR replacement date by providing automatic replacement for certain contracts (e.g., those that lack fallbacks), and also providing that a determining party may select the Board-selected benchmark replacement in situations where they have discretion.[6] A determining party must do so by the *earlier of* the LIBOR replacement date and the latest date allowable under the contract,[7] with the limitation that the statute does not alter or impact contracts where fallbacks identify a replacement that is not based in any way on any LIBOR value.[8] The statute continues that "If a determining person does not select a benchmark replacement by [the LIBOR Replacement Date], the Board-selected benchmark replacement, on and after the LIBOR replacement date, shall be the benchmark replacement for the LIBOR contract."[9] This makes clear that the intent of Congress was that benchmark replacements should be applied to all in-scope contracts, including determining party contracts, (2) no later than the benchmark replacement date (or first reset following that date, as a practical matter). The statute does not contemplate pre-cessation or other triggers in this regard.

For clarity and consistency of implementation of this regulation, the final rule should confirm that:

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[4] Proposed Rule § 253.3(b)(1)
[5] Contracts that include lookback mechanisms in their fallbacks should keep using LIBOR until the first reset when looking back at a screen on that "lookback day" LIBOR was no longer representative.
[6] See LIBOR Act §104(c)(1)
[7] See LIBOR Act §104(c)(2)(B)
[8] See LIBOR Act §104(f)(2)
[9] See LIBOR Act §104(c)(3).

(1) § 104(c)(3) of the statute applies to an in-scope contract regardless of the reason that the Determining Person has not selected a benchmark replacement rate.
(2) For all in-scope contracts, a determining person may transition to the Board-selected benchmark replacement by the first reset after 6/30/23 pursuant to Section 104(c)(1) and Section 104(c)(2)(B) of the LIBOR Act.

C. Synthetic LIBOR Discussion

We do not believe the final rules should address provisions in contracts not covered by the scope of the legislation, such as those having fallbacks to a Prime or other non-LIBOR-based rates.[10] As such, we recommend that the final rule not include any additional clarification or interpretation concerning synthetic LIBOR or the lack of an express nonrepresentative trigger which would impact out-of-scope contracts.

Related to this, we believe it would be helpful for the final rules to provide clear guidance that all in-scope contracts should transition to replacement benchmarks either through their selection by determining parties or by operation of the statute. The clear intention of Congress was that all US dollar contracts move to a representative, non-LIBOR-based rate following the LIBOR Replacement Date, and the Statute is specifically designed to facilitate the replacement of a non-representative LIBOR (or still non-representative reformulation thereof such as synthetic LIBOR) for all in-scope contracts. The statute indicates Congress' finding that the cessation <u>or</u> non-representativeness of LIBOR could result in disruption to contracts which do not provide for a "clearly defined or practicable" benchmark replacement.[11] This is also clear in the definition of the LIBOR replacement date, which is premised on the cessation of publication <u>or</u> cessation of representativeness.[12] Congress further describes the purpose of the statute as "to establish a clear and uniform process…for <u>replacing</u> LIBOR in existing contracts." [13] The statute does not provide optionality for the LIBOR replacement date to be extended to some as of yet undetermined point in the future. Given this, we believe a clear statement in the final rules that all in-scope contracts will transition to alternative benchmarks would help avoid confusion and disagreement among contract counterparties in the event that a synthetic USD LIBOR is produced.

D. Certain Derivatives Where LIBOR is Defined Through Reference to Cash Securitization Products

We believe that the final rule should provide an exception to the general Board Selected Benchmark Replacement provisions generally applicable to derivatives for certain derivatives contracts that specifically refer to the definition of "LIBOR" in an asset-backed securities product that is subject to the LIBOR Act. For example, a balance guaranty swap may define LIBOR by referencing its definition in a CMBS pooling and servicing agreement. The intention of swaps that contain these specific references is to hedge cashflows in the related securitization transaction, and disruptions to this hedging relationship because of divergent benchmark replacements could have unintended consequences to the cash transactions.

We believe this exception should be limited to instances where the universe of swaps and their related asset-backed securities transactions can feasibly be identified due to the linkage of the definition of LIBOR. This would involve swaps that include in their documentation the use of a LIBOR definition in an

[10] See LIBOR Act §104(f)(2)
[11] See LIBOR Act §102(a)(3)
[12] See LIBOR Act §103(17).
[13] See LIBOR Act §102(b)(1)

asset-backed security[14] indenture or other governing document (or calculation methodology) that is subject to the LIBOR Act. These swaps should be permitted to transition to the same benchmark replacement as the associated asset-backed security.

We do not believe it is practical (or advisable) that every swap related to every cash product should be transitioned in this manner. For one, in many cases it is impossible to know what the original intent of the transaction would have been. Secondly, it is not operationally feasible for swap counterparties to identify all such swaps. The preamble to the final rules should acknowledge that regardless of the original intent of the parties, there will be misalignments between many cash products and their related hedges because the Board-selected benchmark replacements for these products differ.

E. Benchmark Replacement for GSE Contracts

The proposed rules would transition certain GSE contracts to average SOFR. Our members' preference, and that of non-SIFMA member investor clients who have provided feedback to our members, is that GSE contracts transition to term SOFR as their Board-Selected Benchmark Replacement instead of average SOFR.

In addition to a general preference for term rates, the expectation of market participants has been that GSE securities would likely transition to term rates, given that each of Fannie Mae and Freddie Mac have indicated in their LIBOR Transition Playbook that they were considering shifting legacy transactions to term SOFR, and also are considering shifting new transactions from average SOFR to term SOFR if approved by relevant regulatory bodies.[15] Ginnie Mae has indicated similar intentions and has placed term SOFR as the first preferred choice for legacy CMO transactions.[16] Term SOFR is a much less complex change for market participants to implement, and also maintains the term structure of the rates on the existing securities.

If the final rules transition GSE contracts to an average SOFR this will likely bifurcate the market, given that GNMA has indicated that it would shift to term SOFR for its multiclass products[17]. GSE and Ginnie Mae multiclass securities share an investor base, and there is a strong desire that the products remain aligned in terms of their reference rates. We see no countervailing benefit to the implementation of benchmark replacements that contradict market desires and expectations and that would also require a more complex implementation. We believe that the Federal Reserve should discuss this issue directly with the GSEs prior to the finalization of these rules. For all of the foregoing reasons, we believe the final rules should transition legacy GSE contracts to term SOFR.

F. Conforming changes

We have four suggestions for conforming changes that should be included in the final rule:

1. *Business Day* - The final rule should include a conforming change that clarifies that contractual definitions of a 'business day' would be aligned with the definition of business day in the Proposed Rule. While determining persons could implement these changes on their own, we

[14] Asset-backed security should be defined in accord with the definition in the SEC's Regulation AB (17 C.F.R. 229.1101(c))
[15] See Fannie Mae and Freddie Mac "LIBOR Transition Playbook", available here: https://capitalmarkets.fanniemae.com/media/5206/display
[16]GNMA, at 23-24.
[17] See GNMA "LIBOR Index Transition Reference Guide" (GNMA) available here: https://www.ginniemae.gov/newsroom/publications/Documents/LIBOR_Transition_Reference_Guide.pdf

believe it will serve efficiency and consistency across the market if the Fed were to publish a model conforming change for the market participants to implement.

2. *Non-Publication of Benchmark Replacement* - Section 253.4(d), which provides that if the Board-Selected Benchmark Replacement is not published on a given day the prior day's BSBR will be used, should be reformulated into a conforming change. Doing so will allow for standardization of this conforming change for non-consumer contracts and also allow consumer contracts to avail themselves of this important detail, if needed.

3. *Publication of an Index for Consumer Products* - There is a reference in many consumer loans to LIBOR as an index "published in the Wall Street Journal". Since the Refinitiv Fallback Rates will not be published in the Wall Street Journal, the final regulations should confirm through inclusion of a conforming change that this is an acceptable change for consumer products.

4. *Bifurcation of Calculation for Some Consumer Lines/Loans* - There is a population of legacy consumer lines of credit and loans that use the average of 1-month LIBOR (typically determined as of the first of each month) over the previous 12-month period. The Board-Selected Benchmark Replacement for consumer loans (as published by Refinitiv) cannot be used before June 30, 2023 because of the transitional spread adjustment. Therefore, Determining Parties will likely have to bifurcate the calculation of this average using LIBOR before June 30, 2023 and using the Refinitiv Fallback Rates thereafter. This will be a change to way that the average is calculated and may differ from prior index replacements that had historical rate data available for use. For the avoidance of doubt and confusion, the Fed should publish a conforming change related to the recalculation of index rates for these products.

G. Eurodollar rates (RFC 4)

We believe that the nullification provisions of § 253.3(a)(2)(ii)(B) should also apply to Eurodollar rates.

H. Notice obligations (RFC 6)

We do not support the final rule creating notice obligations that are in addition to what is required by the contracts themselves, and we note that the legislation provides parties "shall remain subject to the terms of a LIBOR contract that are not affected by this Act". We believe existing contractual provisions should govern this issue, supplemented by ARRC and other industry 'best practices' if needed.

I. Incorporation of Statutory Protections (RFC 8)

The Proposed Rule requests comment on whether the final rule should incorporate the statutory protections in Section 105 of the Act. We believe the final rule should incorporate the statutory protections from Section 105 of the Act.[18]

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[18] If the final rules maintain the proposed structure involving covered contracts and non-covered contracts, which we believe is unnecessary and confusing, the final rule should clarify for the avoidance of doubt that the statutory protections are available to both Covered Contracts and Non-Covered Contracts that fall within the scope of the statute.

We would be pleased to discuss these comments in more detail at your convenience. I can be reached at 212-313-1126 or ckillian@sifma.org.

Sincerely,

Chris Killian
Managing Director
Securitization and Credit