

## **TOM WIPF: THE ENDGAME FOR LIBOR**

JUNE 2021

Featuring:

Tom Wipf, Governor, Chair of the Alternative Reference Rates Committee

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**TOM HOARE:** Hi everyone, it's Tom Hoare. Thank you for joining us for another episode of our BNY Mellon Perspectives podcast series. We've got a really informative discussion for you today with widespread market implications. It focuses on the end of LIBOR.

Now what exactly is LIBOR? For those who don't know, a wide range of financial products such as derivatives, bonds, loans, structured products and mortgages, use benchmark rates to determine interest rates and payment obligations. Benchmark rates are also used to value certain financial products and as a performance tracker for funds, among a number of other purposes.

The London Interbank Offered Rate, or LIBOR), is probably the most widely-used benchmark, used in financial products across a number of global currencies, including the U.S. dollar.

To give you an idea of how important LIBOR is at present, over \$400 trillion worth of financial arrangements are underpinned by LIBOR around the world. \$400 trillion.

As far back as 2014, financial regulatory authorities expressed their concern that the interbank lending market, which LIBOR is intended to reflect, was no longer sufficiently active or liquid. Fast forward to March 5 of this year, the market was finally provided some clarity as to LIBOR's projected end date, which is when LIBOR settings will either cease, or no longer be representative.

So as a global bank that is really at the center of so much in terms of our global capital markets, we wanted to provide a little bit of context and a little bit of education too. So we brought together BNY Mellon's Executive LIBOR Programme Director Oliver Bader with Tom Wipf, chair of the Alternative Reference Rate Committee, or ARRC. ARRC is the body responsible for engaging in cross-industry consultations and proposing the U.S. dollar LIBOR replacement.

Tom and Oliver sat down to reflect on the confirmed LIBOR deadlines and implications for the market, key focus areas for firms as they transition to alternative reference rates and whether the market can expect a U.S. dollar LIBOR replacement this year. Tom provides us with an exclusive view around the conditions for a term rate and when the market can anticipate there being one.

He also reflects on what ARRC's priorities are likely to be in 2022 and 2023, when the majority of LIBOR settings cease to be published, and their significant implications for market participants as they prepare for LIBOR's end game.

So it's an educational discussion; it's a really detailed discussion; and it covers a topic that really has massive implications for the global economy. I really hope you enjoy the discussion and learn something new. And as always, share your feedback. Listen, rate, review; tell us whatever you think wherever you listen to your podcasts. We'll see you at the next episode, and please enjoy this conversation between Tom Wipf and Oliver Bader from BNY Mellon. Thanks again.

OLIVER BADER: The first four months of 2021 have witnessed the release of several highly significant LIBOR announcements, including definite LIBOR end dates. We're here today with Tom Wipf, the ARRC chair to reflect on what these announcements are likely to mean for most firms as they reconfigure their plan to cease using LIBOR. So Tom, welcome to our podcast. It's great to have you.

TOM WIPF: Great to be here.

OLIVER BADER: Thank you for joining us today. A lot of people know that you have a long-established and successful career in banking, but they may not necessarily be aware that you're also a successful musician and veteran guitar player. Now, I assume that LIBOR probably isn't one of the main topics you normally discuss during gig rehearsals, but if the topic would arise, how would you explain the topic as well as your role at the ARRC to somebody who is not dealing with the matter on a daily basis?

TOM WIPF: Oliver, thank you for that. When we really look at this and the enormity of this and the complexity of this work, we've been at this since 2014. And the goal of replacing a rate that's used in so many different contracts, in over \$225 trillion in contracts, rests on LIBOR. I think the best example is it's a very, very complicated piece of music and it involves a lot of collaboration, a lot of coordination. And musicians, I'd say if the analog is musicians, it would be people who need to listen and play and also be able to collaborate well to create a good outcome at the end. So like any band, it's a lot of moving parts. It's a lot of complications, but in the end, if we get it right, it's going to sound perfect.

OLIVER BADER: Thanks, Tom, for giving our listeners a solid bird's-eye view on what this transition is all about and also kind of comparing that to a piece of music. Now, zooming in to the major building blocks, I think it's fair to say that we have seen several significant market updates since last November. Can you provide us with a summary of the key developments and their implications for the market? And do you think the delay of the cessation date for U.S. dollar LIBOR, for instance, offers a breathing space for firms' implementation timelines?

TOM WIPF: Yes. Thanks, Oliver. So what we've got here, really, it does give us breathing space to roll down legacy trades. It does not give us breathing space to create new LIBOR. So the announcements that we got at the end of last year as it related to Dollar LIBOR – which, like all the other IBORS was scheduled to sunset at the end of this year – there were a series of announcements. Now the other IBORS will sunset at the end of this year, and those plans are moving along quite well. For Dollar LIBOR, I think due to the size and scope and progress that needed to happen, there was a compromise made between an extension on the back of 18 months to June of 2023. But that came with very direct supervisory guidance from U.S. Prudential banking regulators – the Fed, OCC, FDIC, and that interagency point which said no new LIBOR at the end of this year.

So what we've got is, we stopped the production, so we've now formalized. What I've been saying for years was we have to stop digging the hole. So we formalized that with supervisory guidance of no new LIBOR. And we have 18 months now to roll down some of these existing legacy contracts. Those contracts, if you think about it just in big numbers, there's \$225 trillion in outstanding LIBOR reference contracts today. Using this additional runway, 67 percent of that will roll down before June of 2023. That reduces all the operational risk and everything else that comes with the final transition, significantly. So that's the critical piece of this.

We look at it, we described this as a roll down corridor where we have an opportunity to stop new production with supervisory guidance, use this additional 18 months to maximize the organic roll down of the maturities that we'll see, and arrive at a much safer place, not that much later than we had planned.

OLIVER BADER: Like you just said, Tom, we have the ARRC guidance for best practices a year ago with the supplement also of the interagency statement in November of 2020 to stop using U.S. Dollar LIBOR at the end of 2021. How would you describe the readiness of the market by product segment if we take floating rate notes, loans, derivatives and securitizations kind of to stop using LIBOR for those new transactions?

TOM WIPF: I think we've tried to lay out a path which is between the ARRC best practices going by product, which offer dates where a market participant, if they follow those best practices, should have the smoothest transition, and the hard supervisory stop at the end of this year. So, what we do is we try to balance that. So we've really looked product by product. Certainly, the floating rate note market is adapted to SOFR, and there's a lot of activity there using a number of conventions. The derivatives market continues to rely on LIBOR, but everyone has signed the protocol, so the fallbacks actually convert to SOFR. It's an important point about liquidity. I mentioned the \$225 trillion. I've mentioned the 67 percent rolling down.

So what we have is this huge pool of SOFR liquidity out there on the curve. And all we're trying to do is now move to get people to start using SOFR more actively, particularly in a derivatives market, which will link it to some other things I think we're going to discuss. But overall product by product, the answer is ARRC best practices are the best path to follow, but nonetheless, we got a hard stop on all products at the end of 2021 for new production.

OLIVER BADER: Yeah. Looking still at 2021 and in respect of that SOFR readiness milestone, are there any outstanding tasks that the ARRC is still working on for this year?

TOM WIPF: Yeah, the ARRC has been really, I think, trying to be very transparent about the desire for some to have a forward-looking term SOFR rate. So, although many products can use overnight SOFR compounded in advance or in arrears, the Fed averages that are available which are currently used in the consumer mortgage market. But there's still a cohort of participants who definitely would like to have a forward-looking term SOFR. The ARRC had promised to deliver that in June, but I think we always assumed that that was more state dependent than date dependent. So we needed the derivatives market to pick up a little bit more in terms of volume before we could endorse a forward-looking term SOFR, because obviously when the ARRC endorsement matters, because it's going to be used for all the fallbacks, and we want to make sure it's robust and we don't replicate any of the weaknesses that we've seen in LIBOR.

So what we've done, is two critical dates out there as relates to term SOFR. The first is that the ARRC has been communicating nearly every week on a path-to-term SOFR. We publish principles of what we would need to see. We publish market indicators on what needs to happen. And we will over time identify a producer of that rate. And then when the market indicators are met, we'll endorse that rate. So when we put that all together, we've got a path to term SOFR. What's the last piece of the puzzle? Getting the derivatives market to go directly to SOFR.

Now from an economic perspective, Oliver, it already is. Everybody assigned a fallback. If you do a 10 year swap today, you're doing two years LIBOR and eight years of adjusted SOFR. So when we put it all together, what we really need to do is to have the quoting conventions and the derivatives market move.

We've been doing a lot of work with the CFTC's Market Risk Advisory Committee, and we hope at some point by the summer, we'll be able to announce a date in this summer for when those conventions change. This has been a path that was blazed in the UK, and it worked very well. Once the inner-dealer markets changed their conventions, once pricing conventions changed over there from Sterling LIBOR to SONIA, the market shifted completely.

So what we're telling people in the market, as best they can, is if you have a desire to have a term SOFR, encourage your derivatives desk to get on board and begin using SOFR as a first choice in this. And this initiative, you'll hear a lot about it, it's called SOFR First, completely copied from the UK SONIA First. So, stay tuned. That's going to be a big piece. If we can get the derivatives market to move on new production, we have a really good chance of delivering a forward-looking term SOFR shortly following that.

OLIVER BADER: You just mentioned the UK, Tom, is there anything else – you mentioned already the SONIA First and SOFR First – is there anything else you think we could learn also from what we're seeing in the UK on SONIA and term rates on SONIA?

TOM WIPF: Yeah, I think there was a real collective. And obviously look, there's a very different regulatory framework in the United States then there is in the UK, just even benchmark regulation

doesn't even exist in the UK. So we're working across many, many regulators, many market participants and the diversity of participants at Dollar LIBOR is much wider than some of the other currencies.

Nonetheless, we look at all the other working groups and what's worked and what hasn't. So obviously Switzerland might as well, they're done. They got the work done. There's no need for a forward-looking term rate. Everything is done at compounding. We followed what's happening in Canada: there's progress there. We follow Europe, where they'll all look like they were behind, but seem to be accelerating pretty rapidly. But the UK, to your point, lays out what the path is. We've got to get the derivatives market moving first. That's critical. But they've done great work.

So what we've done in terms of legislation in the U.S., on tough legacy things like floating rate notes, perpetuals, trust-preferred securities... We've got New York state legislation enacted into law that substitutes ARRC fallbacks in there. In the U.K., they're going down a route of a synthetic LIBOR, but that's really jurisdictional and based on the different prevailing laws.

Nonetheless, every working group wants to address tough legacy through some form of legislation. Every working group wants to get to a risk-free reference rate first in the derivatives market as a critical path to moving forward. So yeah, we're tracking everything that works, and I'd have to say from the U.K. perspective, the SONIA First initiative was hands down one of the biggest things that moved that market. So we're hoping to track that and hope we can be even half as successful as they were.

OLIVER BADER: Okay, Tom, great. Staying on rates for a little bit longer, beside the desire of some market participants to have a term rate, they are also others out there who have voiced their wish for credit sensitive rate. As SOFR can't deliver on both fronts, we're seeing currently the emergence of a number of new rates being offered by various market providers. How do we evaluate these developments? And do you believe that these rates could have a negative effect on the ability of SOFR to gain traction and momentum over the next couple of months?

TOM WIPF: I think the way we've looked at this, of course, there could be alternatives, but we would encourage everyone to carefully consider the reference rates that they use, and actively work to understand what they represent, how robust they are, whether they're sustainable or have been sustainable over time, to ensure we don't want to do this again. So our one message is, we want to do this right, and we want to do it once.

Legendary UCLA basketball coach John Wooden said, "If we don't have time to do it right, when will we have time to do it again?" And so, we really are focusing on, "Let's get this right and do it once." We believe SOFR can cover all products. So, from the ARRC's perspective, we selected SOFR after a long consultation. We believe that with a trillion dollars in underlying activity, it forms the best foundation.

Now, we did a careful evaluation of that and we chose that. Nonetheless, the other thing we're asking people to do is know what's in your reference rate. So you need to look at every one of these alternatives very closely. One, what data they rely on. Is that data going to be dependable over time? How big is the data set? How is the calculation methodology? And most importantly, just stress test

up to March of 2020. And if they suit your business, that's fine. But I think when people really look closely at these things, we still would stand by the fact that SOFR is the best alternative. And as I mentioned, that pool of liquidity sitting out there, \$75 trillion plus waiting for the end of June 2023, means that SOFR will have the dominant liquidity position. And in my opinion, liquidity tracks liquidity. And that's why LIBOR was so popular.

OLIVER BADER: So I know our focus is still on 2021, but now let's move on into 2022 mentally. And if we put ourselves into a LIBOR project lead phase, a scenario in which only limited transition activity was likely to occur in the first nine months of 2022, what recommendations would you give them regarding governance in driving the project?

TOM WIPF: Well, that is an outstanding question, I think, and that really speaks to the key part of this. We are now in the process of mitigating market risk is the protocols, CCP conventions in terms of converting trades, everything we're doing using ARRC fallback language, using SOFR as a first choice – all those things are really market risk related. So we're trying to reduce market risk now, and that's really what the race is going to be between now and no new LIBOR at the end of 2021.

But let's look at these programs broadly. The real work for these programs, largely, is going to be ops and technology and re-papering, and actually using these fallbacks. So, we talk about fallbacks like the use of protocol and ARRC fullbacks as they're like seat belts. You want to have them, but you don't want to use them. So the goal would be you can't let these programs atrophy even slightly, because at the end of this... When we think about getting to the end of LIBOR and these programs, the point we get is that everything that we're doing now to eliminate market risk is creating some form of future operational risk. So we cite a fallback.

Well, we have to go through that fallback. We have to repaper loans. We have amended fallback language in a lot of loans. We have to go back and conduct those amendments. We have all the things that we have to work through a waterfall, create playbooks and do that. So really when you think about it at the end of 2021, we should be, if we remain on schedule, in a place where we've mitigated an enormous amount of market risk, but we now are facing the real work, the repapering, the operational aspects, working through these things, connecting with clients, doing everything that we're supposed to do at the end, and that's going to be a lot of work. And I think making sure that people carry these programs forward, but shift their focus from market risk to operational risk and completion of the transition.

OLIVER BADER: Yeah. And Tom, shining the light on maybe one aspect of really that transition, that second part: If we think about over the last few decades, the process of disseminating data for bond and securitization issuers to market data providers has been established by new issuances or corporate actions. But as some of the solutions for tough legacy may not require those channels, like for example the legislation, has the ARRC considered ways in which changes and fallbacks will be communicated throughout the market?

TOM WIPF: Yes. And I think we've always tried to say, well, look, even though we've got the

legislation, we also have to get how these terms are going to be applied. So the ARRC in the New York state legislation, and most hopefully the federal legislation, but wherever it is, but the New York state legislation right now designates the ARRC and SOFR. So we have to actually lay out what those conventions are. So the ARRC is going to play a role in everything related to New York legislation, everything related to ARRC fallback. So the ARRC has selected a calculation agent, and the ARRC has done some work on this, but we will be designated and have that responsibility. So yeah, as we approach those dates, the ARRC will be delivering very clear information to the market on how to actually apply these fallbacks as best we can.

OLIVER BADER: So, let's fast forward on that point to January 2022, and after the U.S. market has successfully stopped using U.S. Dollar LIBOR, the other currencies, the panel banks have stopped submitting their daily LIBOR rates. Euros and Swiss LIBOR has ceased completely; Sterling and Japanese Yen, you said it might see syntactic versions, and until U.S. Dollar LIBOR, we'll have another 18 months to go. So, in that context, what will be the priorities off the ARRC in 2022 and 2023? Have you already a bullet point list of what those priorities will be?

TOM WIPF: Yes, I do. And I think that our goals are going to be that same discussion. What do we have to shift aggressively from market risk mitigation to operational risk mitigation? What are the things that we can do? How do we maximize that extra 18 months or that additional time to deliver on a smooth transition?

So, in that period, we're going to be encouraging people to deal with their amended fallback language in loans, address their tough legacy, understand how they're going to transition it. But the work really, it can begin now, but it certainly needs to begin as we enter 2022, as market participants think about, okay, what is all this stuff I signed up for? And what do I have to do when I get there? So I think inventorying those things, seeing what can be done in advance, negotiating things up to the front.

Because really, I think we all want to get to a point where we don't want to be in a position of dealing with a whole bunch of fallbacks and of working through all that, if we can, in fact, work with customers to voluntary convert, to have different things. But we really think that is an opportunity at the end of this year for people to think about controlling their own destiny by voluntary conversions, by bilateral negotiations, but clean up that last pile between now and then, and all of a sudden we won't have that much left to deal with. And I say not much left, we're dealing in trillions, so a lot, but not much on a relative basis from where we stand today.

OLIVER BADER: Tom, thanks for your thoughts on that and doing this podcast with me. And let's hope that this will be a very successful music piece at the end where we will all also in retrospect, want to listen to. Thank you very much again.

TOM WIPF: Well, thank you very much for the opportunity to speak to this very, very important set of constituents. So, thank you for your time.