October 30, 2017

SUBMITTED VIA EMAIL
regs.comments@federalreserve.gov

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

Re: Request for Information Relating to Production of Rates
Notice: request for comment
Docket No. OP-1573

Dear Ms. Misback:

The Structured Finance Industry Group ("SFIG")[1] appreciates the opportunity to respond to the Board of Governors of the Federal Reserve System ("Board") notice ("Notice") seeking public input on the production and publication of three rates by the Federal Reserve Bank of New York ("FRBNY"), based on data for overnight repurchase agreement transactions of Treasury securities. For ease of reference, terms defined in the Notice are used herein as therein defined.

SFIG is a member-based trade industry advocacy group focused on improving and strengthening the broader structured finance and securitization market. SFIG's core charge is to support a robust and liquid securitization market, recognizing that securitization is an essential source of funding for the real economy.

Introduction

SFIG appreciates the overall need for the production and publication of new alternative benchmark interest rates and supports the objective of new benchmark rates that are derived from actual market transactions covering the broadest possible segment of the market. There is broad consensus to support the development of new benchmarks, including the Secured Overnight Financing Rate ("SOFR") and the other rates proposed by the Board. For convenience of reference in this comment letter, in

[1] SFIG provides an inclusive network for securitization professionals to collaborate and, as industry leaders, to drive necessary changes, be advocates for the securitization community, share best practices and innovative ideas, and educate industry members through conferences and other programs. Members of SFIG represent all sectors of the securitization market, including issuers, investors, financial intermediaries, law firms, accounting firms, technology firms, rating agencies, servicers, and trustees. Further information can be found at www.sfindustry.org.

some places we will refer to the rates proposed as described in the Notice as simply "SOFR", inasmuch as SOFR appears to be the most useful of the three rates as a benchmark for the securitization industry.

The Notice comes against the backdrop of the announcement in July 2017 by the Chief Executive of the U.K. Financial Conduct Authority ("FCA") of the FCA's intent not to compel panel banks to contribute to LIBOR (either through the FCA's legal compulsion powers or influence) after 2021. At this time it is not known if LIBOR will continue after 2021. A post-2021 continuation of LIBOR would depend on further enhancements to the process for producing LIBOR to assure its integrity and make it based on actual transactions, as well as the willing participation of panel banks in submitting rates. What is clear is that market participants cannot at this time depend on the continuation of LIBOR post 2021, and that in any event the financial markets will benefit from the development and production of new benchmark rates. From this vantage point, SOFR can be considered both as an alternative to, and a replacement for, LIBOR.[2]

Our comments below are mainly organized by topic. We would also note that a shift away from LIBOR will have very significant ramifications for legacy transactions. We do not believe, however, that a discussion around the legacy issue falls within the scope of a response to this particular proposal. We do, of course, look forward to addressing this in the future.

Comments

SOFR

Of the three rates proposed in the Notice, the SOFR would appear to be the most useful to the securitization market as a benchmark because it is based on the broadest dataset. However, we have concerns about some of the transactions in the dataset. The bilateral trades cleared through the Fixed Income Clearing Corporation ("FICC"), being "specials" as described in the Notice, as opposed to general collateral ("GC") trades, do not reflect a riskless market collateralized lending rate, but rather may be artificially deflated because the funds provider is paying for the use of a specific security.

We appreciate the effort that has already been put into designing SOFR to attempt to filter out specials trades, as discussed in the FRBNY's recent Liberty Street Economics post.[3] That post suggests eliminating FICC cleared bilateral trades with rates below a certain threshold, such as below the 25th volume weighted percentile rate. We believe this approach has merit, and we would appreciate the publication of a more detailed methodology by the Board, together with historical analysis that

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[2] While the Notice itself does not reference LIBOR, the accompanying press release does take note of the Alternative Reference Rates Committee's endorsement of SOFR as its recommended alternative to LIBOR.

[3] See Kathryn Bayeux et al, "Introducing the Revised Broad Treasuries Financing Rate," Federal Reserve Bank of New York Liberty Street Economics (blog), June 19, 2017, http://libertystreeteconomics.newyorkfed.org/2017/06/introducing-the-revised-broad-treasuries-financing-rate.html

illustrates the application of the methodology. We also suggest that the specific mechanism for trimming these rates, to filter out non-GC repos, be subject to fine-tuning from time to time.

Term Curve

We believe that in order for any of the rates proposed in the Notice, including SOFR, to be broadly accepted as alternative benchmark rates in the securitization market, it will be necessary for FRBNY or another party to publish term rates for the most significant maturities (e.g., one month, three months, six months and one year), so as to enable the creation of a typical yield curve, similar to LIBOR's current forward-looking term structure. In both commercial and consumer loan documentation with floating rates based on LIBOR, the rate is generally reset not daily but periodically, and therefore the specific LIBOR benchmark used may be, for example, one month, three month, six month or one year LIBOR. The reason for this is to provide the borrower with a predictable payment amount on such obligations for which interest is generally payable on a monthly basis, and on which the rate may be adjusted monthly, quarterly, semi-annually or annually. Daily resets could cause uncertainty to borrowers who need to understand and plan for upcoming interest payments. In the operative documentation for asset-backed securities that pay interest based on LIBOR, the rate is similarly reset not daily but periodically, to reduce basis risk relative to the rates on the pooled assets.

We understand that it may be possible, once publication of SOFR has begun, to derive a term curve based on futures and options contracts based on SOFR. However, it arguably would be better to derive a term curve of SOFR based on the same underlying dataset from which SOFR is derived, so as to be based on actual reported repo transactions in which a term rate is set (to the extent data on such transactions are sufficiently available), rather than anticipated future values of the proposed rates. In addition, to the extent that the proposed rates as implemented are overnight rates only rather than term rates, it cannot be known with certainty at this time to what extent a robust futures/options market will develop, or if it will be useful to infer longer tenors of SOFR on the term curve.

We note that in the Treasury repo market, repo transactions are not only entered into on an overnight basis, but may also provide financing for various terms generally up to a year. We also note that according to the Notice description of the datasets in the tri-party repo market, as well as the GCF Repo data, such data include the maturity date of the trade. Therefore, it would seem to be possible to bucket trades in these two data sources by maturity, so that a curve could be derived showing the rate not only as an overnight rate, but also with terms such as one week, one month, three months, six months and one year. We recommend that consideration be given to how FRBNY or another party may be able to derive term rates from these data sources. This suggestion is contingent on whether the data sources contain sufficiently robust data on term repo transactions from which such term rates could be derived, and whether from this perspective the data sources used for this purpose would be compliant with applicable standards for interest rate indexes (including International Organization of Securities Commissions standards).

The availability of a term curve for SOFR would in our view significantly improve the prospects for SOFR being broadly accepted by market participants in the securitization market, either as an alternative to or a replacement for LIBOR.

"Riskless" Rate

The Notice does not specify if the proposed rates are intended to be nearly "riskless", i.e. market rates that do not include any material risk premium due to the credit of the borrowers in the trades from which the rates are derived. We believe the market is expecting new benchmarks to reflect a nearly riskless rate. We recommend that the datasets be considered from this perspective. Are there variations in the interest rates on the repo transactions within the data sets that could be attributable to a credit element in the underlying transactions, such as variances in the haircut level? Put another way, if there are significant ranges of interest rates within comparable transactions in the data set, are these ranges attributable to credit factors, or to other market factors?

This question may be relevant to the utility of the proposed summary statistics to accompany the daily publication of the rates.[4]

Lookback Historic Data

In order for market participants to develop a sense of confidence that SOFR will perform in a manner similar enough to LIBOR (minus a margin to account for greater risklessness of SOFR as compared to LIBOR) to become a generally accepted alternative to or replacement for LIBOR, we believe the market would benefit from the most robust lookback historic data possible.

To support this, once the methodology for producing the new rates is set, we recommend the production and release of extensive lookback historic data. This would be produced by applying the methodology to the same datasets that the new rates will be based on over a lookback period, to the extent those datasets are available. It would appear from the Notice that the clearing bank data (at least as to the Bank of New York Mellon) on tri-party repos, as well as the GCF Repo data from the Depository Trust & Clearing Corporation, should exist for a considerable lookback period.

We understand that some lookback historic data has been published by the FRBNY.[5] However, this information is only for a limited period from 2014-2017, and only shows the overnight rate.

We are recommending that historic lookback data be produced and provided for a lookback period from 2007 through the launch of the new rates. Alternatively, and to assist users in making calculations required for regulatory/accounting measures over a required five year period and at least one period of market stress, we would recommend that historic lookback data be produced and provided for a five year lookback period, and for 2008 as a stress event year.

We are also recommending that historic lookback data be produced and provided for the lookback period, for all tenors of the new rates (overnight to one year) as discussed above under “Term Curve”.

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[4] As proposed, the 1st, 25th, 75th and 99th volume-weighted percentile rates, as well as volumes.

[5]Published at: http://www.newyorkfed.org/medialibrary/media/research/blog/2017/LSE_2017_Cipriani_broadfinancing_data.xlsx

As noted above, this suggestion is contingent on whether the data sources contain robust enough data on term repo transactions from which such term rates could be derived.

We believe this would enable market participants to compare the historic performance of SOFR with the performance of LIBOR of various tenors over a sufficient period to enable observers to develop a consensus as to the correlation between SOFR and LIBOR.

Quarter-End Spikes

Based on a review of the limited historic lookback data published by FRBNY, it appears that the proposed rates as overnight rates display a tendency to spike considerably around the last day of a calendar quarter. One of our members performed a review of the historic lookback data provided by FRBNY and summarized quarter-end volatility by comparing the maximum change in the SOFR from two business days prior to quarter-end to two days after, and also provided comparable information as to overnight LIBOR.

	SOFR			ICE Libor USD Overnight		
QUARTER	**5 Day Max (bp)**	**5 Day Min (bp)**	**5 Day Difference**	**5 Day Max (bp)**	**5 Day Min (bp)**	**5 Day Difference**
Q3 2014	4	0	4	9	8	1
Q4 2014	10	8	2	11	8	3
Q1 2015	20	12	8	12	11	1
Q2 2015	16	10	6	12	11	1
Q3 2015	22	10	12	13	11	2
Q4 2015	45	35	10	36	27	9
Q1 2016	41	35	6	38	37	1
Q2 2016	60	40	20	41	40	1
Q3 2016	90	45	45	42	42	0
Q4 2016	55	48	7	69	68	1
Q1 2017	88	76	12	93	92	1

We believe this is a significant difference in performance as compared to LIBOR. LIBOR and the underlying interbank deposit rates historically do not indicate a spike in rates due to lack of liquidity at quarter-end, likely due to liquidity requirements to which banks are subject. But because the transactions underlying the new rates involve a broad set of market participants, some of whom are subject to short term higher liquidity needs around quarter-end, it appears the new rates as currently envisioned will spike at quarter-end.

We believe that this is an aspect of SOFR that needs to be considered, as it could affect market acceptance of SOFR as an alternative to or as a replacement for LIBOR in the securitization market. For example, a borrower under a commercial loan would not want its rate for a one- or three-month period

to be set by reference to one of the new rates (on an overnight basis) as of the end of a quarter if spikes are expected.

It is possible that given the production of the new rates in various tenors along the term curve as we have proposed, this tendency to spike may smooth out. The interest rate on a three month repo entered into on the last day of a quarter should not spike in the same way as an overnight repo would. This observation underscores the need for the proposal to be modified to generate rates of various tenors, as well as the need for extensive historic lookback data as we have proposed.

We recommend that further consideration be given as to whether the methodology for producing the proposed rates on an overnight basis can be adjusted to filter out the effect of quarter-end liquidity spikes.

Posting of New Rates

We recommend that the Board publish the procedures that it will follow in posting the new rates, in advance of the time that production of the new rates begins in 2018. We recommend that the procedures ensure that posting will be made by the same means by which LIBOR is currently available, and through the same service providers and other media. In this regard, market participants will need substantial lead time to update their systems and procedures in order to begin to use the new rates.

Additionally, we are concerned that the proposed daily publication time of 8:30 am ET will be too late in the day for market participants based in the United Kingdom and Europe. Also, such timing would be after the close of business in Asian markets. We recommend that consideration be given to the feasibility of publishing the rates on an overnight basis, for example by 12:01 am ET.

Data Interruption

While the underlying transaction data used to create the new rates appear to be broad and robust, the actual sources of the data that are made available to FRBNY to produce the rates are very few and highly concentrated. Notwithstanding the procedures and safeguards that may be in place to ensure the uninterrupted availability of data from each of these sources, it may be possible for any of these data sources to become temporarily unavailable due to unforeseen circumstances.

We would request that as the development of the new rates moves forward, the Board provide clarity as to the steps that would be taken in response to any such potential data interruption. In our view, a couple of key questions must be considered. If one of the data sources were temporarily unavailable, would SOFR still be published based on the available data? And would a corrected SOFR then be published retrospectively once the interrupted data source becomes available? We would request that there be transparency with respect to this process.

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SFIG welcomes opportunities to work with the Board as it continues to develop and implement its proposal for the production and publication of SOFR and the other rates.

If you have any questions about this response, please contact Richard Johns, Executive Director of the Structured Finance Industry Group, at Richard.Johns@sfindustry.org or (202) 524-6301.

Respectfully Submitted,

Richard Johns

Richard Johns
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Structured Finance Industry Group