July 12, 2019

International Swaps and Derivatives Association, Inc.

Via email to: fallbackconsult@isda.org

Re: Consultation on Pre-Cessation Issues for LIBOR and Certain Other Interbank Offered Rates (IBORs)

The Structured Finance Association (formerly known as the Structured Finance Industry Group) ("SFA")[1] appreciates the opportunity to respond to the International Swaps and Derivatives Association, Inc. ("ISDA") Consultation ("Consultation") on Pre-Cessation Issues for LIBOR and Certain Other Interbank Offered Rates (IBORs).

SFA is a member-based trade industry advocacy group focused on improving and strengthening the broader structured finance and securitization market. SFA'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. While the comments expressed in this letter represent the consensus views of our broad membership, this letter does not necessarily represent the perspectives of all SFA members. None of the recommendations expressed herein are binding on, or should be attributed to, any individual SFA member, each of which will decide for itself whether and to what extent to submit individual comments in response to the Consultation.

SFA views the Consultation as another important step in the overall process of transitioning globally from the various IBORs to new benchmarks based on risk-free rates ("RFRs"). The Consultation seeks commentary on the preferred approach for addressing pre-cessation issues in derivatives that reference LIBOR and certain other IBORs and asks specific questions relating to such proposed approaches ("Questions"). The Consultation seeks commentary from all market participants, both users of derivatives and users of financial instruments that are hedged by derivatives.

SFA's LIBOR Task Force identified potential best practices that SFA members in particular believed would help ensure an as-seamless-as-possible transition away from LIBOR to successor benchmarks. The SFA LIBOR Task Force includes a broad cross-section of SFA members from all of our constituency groups, including, among others, banks, issuers, investors, trustees, rating agencies, and servicers. On December 14, 2018, the LIBOR Task Force published its First

[1] SFA 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 SFA 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.structuredfinance.org.

Edition Green Paper, entitled “A Set of Recommended Best Practices for LIBOR Benchmark Transition” (the “Green Paper”) which set forth SFA members’ initial views on how structured finance market participants may navigate this significant transition, including recommended trigger events, a fallback benchmark rate waterfall, and calculation methodologies for replacement reference rates and spreads. Additionally, SFA has been deeply involved with other industry participants in developing approaches to handle the move away from LIBOR, including as a member of the Alternative Reference Rates Committee (“ARRC”) and as a co-chair of the ARRC Securitization Working Group.

Submitted below, are SFA’s responses (“Responses”) to the Questions. For your convenience, the Responses have been placed in the order in which the Questions were presented, and the text of each Question is presented in italics before the associated Response. Additionally, please note that for the sake of succinctness, we have grouped our responses below as each Response applies to several Questions. Furthermore, please note that in most instances below, we have limited our Responses as they apply to the case of the cessation of USD LIBOR. Capitalized terms that are used in this letter, unless otherwise defined, have the meanings set forth in the Consultation.

As described above, the UK FCA has suggested that the “end-game” for LIBOR may include an assessment by the FCA that one or more LIBOR panels have shrunk so significantly that it no longer considers the relevant rate capable of being representative.

Question 1: *Would you be content to have any contracts that continue to reference the Covered IBOR after the supervisor of the Covered IBOR’s administrator makes a statement that the Covered IBOR is no longer representative? If so, why and under what circumstances?*

Question 2: *What actions would you take if the supervisor of a Covered IBOR administrator makes a statement that a Covered IBOR is no longer representative but the Covered IBOR continues to be published? Please differentiate between ceasing use of that Covered IBOR in new derivative contracts and negotiating amendments to existing derivative contracts. Please comment on LIBOR in particular and explain whether your answers differ across Covered IBORs. Would the facts and circumstances surrounding the supervisor’s assessment and statement affect your actions? If so, how?*

Question 3: *Do you expect to amend or close out your derivative contracts referencing Covered IBORs prior to the possibility of a statement that a Covered IBOR is no longer representative? Please specifically comment on whether you expect to have exposure to LIBOR post-2021.*

Question 4: *Do you expect any impediments to taking the steps you would want to take? How could ISDA mitigate these impediments? What other entities could mitigate these impediments and how could they do so?*

Response to Questions 1-4: We do not have any responses to these specific questions since they relate to the reactions of individual users of derivatives under certain circumstances. That said, we would like to take this opportunity to comment on one aspect the ISDA proposal more generally. As outlined in our October 18, 2018 response to ISDA’s Consultation on Certain Aspects of Fallbacks for Derivatives Referencing GBP LIBOR, CHF LIBOR, JPY LIBOR,

TIBOR, Euroyen TIBOR and BBSW and in the Green Paper, for transactions referencing USD LIBOR, SFA supports the use of a forward-looking term SOFR in the event of a transition away from LIBOR, as modified to reflect the difference between the SOFR risk-free rate and the credit component included in LIBOR. A forward-looking term SOFR would be based on market expectations of SOFR over an upcoming accrual period, and would be available at the beginning of the accrual period. For cash markets generally, such a rate is superior to a daily compounded SOFR either set in advance or in arrears.

Although forward-looking term SOFR rates do not exist today, it is anticipated that such rates will be available ahead of LIBOR cessation, and that these rates will be based on market transactions in derivatives contracts and futures trading that reference SOFR. As such, we suggest that ISDA consider the inclusion of a fallback waterfall for USD LIBOR that allows for forward-looking term SOFR rates selected, endorsed or recommended as the replacement for LIBOR by the Federal Reserve Board and/or the NY Fed, or by the ARRC. Such an approach would allow affected parties to replicate as closely as possible the pre-transition economics of a transaction, and any related hedges would both support cash flow management and minimize market disruption. This would also work to avoid the market complexity and risks that are likely to be created if different fallback rates are employed for cash products and derivatives, and will promote consistency between cash products and derivatives, thus avoiding basis risk.

In the absence of a forward-looking term SOFR at such time, SFA supports a similar approach to that identified by ISDA (i.e., using an average/compound of overnight rates as adjusted to reflect historical differences between LIBOR and SOFR). Alternatively, as discussed further below, some SFA members support an opt in approach whereby transaction parties could identify certain transactions for which a successor rate would be chosen by first looking to a forward-looking term RFR and, if such rate does not exist, then looking at an average/compound of overnight rates to determine the applicable replacement rate.

Additionally, with respect to any pre-cessation announcement, SFA believes that any such statement that a Covered IBOR is no longer representative should be communicated in a manner making it clear that it applies only to new transactions arising after the date of such statement. Given that many legacy transactions may not be able to be readily transitioned to a new benchmark, such an announcement otherwise may create confusion and cause material market disruption.

ISDA IBOR Fallbacks

Question 5: *Would it be appropriate to include a pre-cessation trigger regarding 'representativeness' with the triggers for permanent cessation in the amendments to the 2006 ISDA Definitions and in the protocol that ISDA intends to publish to introduce the IBOR fallbacks? Please explain your answer.*

Question 6: *Is inclusion of the trigger necessary to enhance existing controls and mechanisms already in place contractually and/or under existing law or are these controls and mechanisms sufficient?*

Question 7: *What problems could arise if such a trigger were not included in amendments to the 2006 ISDA Definitions and in the protocol that ISDA intends to publish to introduce the IBOR Fallbacks? Please specifically consider and comment on (a) the potential for a CCP to exercise its discretion to change a reference rate if it determines that a Covered IBOR is no longer sufficiently robust or no longer fit for purpose; (b) management of a legacy portfolio of derivatives referencing an IBOR if use in new contracts is also prohibited by regulation (at least for entities in certain jurisdictions); and (c) derivatives that hedge cash instruments that may have pre-cessation triggers and fallbacks.*

Question 8: *What problems could arise if such a trigger were included? Please also consider derivatives that hedge cash instruments that do not have pre-cessation triggers and fallbacks. Please consider the implications of linking the fallbacks for the permanent cessation of a Covered IBOR with the agreement to convert the Covered IBOR to the corresponding adjusted RFR plus a spread upon a pre-cessation trigger.*

Question 9: *Do you think inclusion of a pre-cessation trigger would positively or negatively affect industry take up of the permanent cessation fallbacks? Please specifically comment on adherence to the protocol to amend legacy derivative contracts.*

Question 10: *What problems could arise if such a trigger were not included in amendments to the 2006 ISDA Definitions and in the protocol that ISDA intends to publish to implement the IBOR Fallbacks?*

Response to Questions 5-10: SFA believes it is important for structured finance transactions to include a "representativeness" pre-cessation trigger in the LIBOR fallback language. This is true for a number of reasons, including that following an announcement that LIBOR is no longer representative, LIBOR rates may behave differently than they had performed historically. We believe that the spread between LIBOR and adjusted SOFR has and will vary considerably over time due to market conditions and other factors. Historically, LIBOR has spiked considerably in times of financial stress. Since many structured transactions use the LIBOR rate as of a specific date to determine interest payments over the next relevant period, SFA members' concerns relating to possible short term swings in LIBOR are greatly amplified.

Relatedly, we believe there is significant value in providing for the alignment between structured transactions and any derivatives utilized in such transactions. This sentiment applies equally to structured transactions that do include a pre-cessation trigger and to those that, for one reason or another, do not contain such a trigger. Many cash products, including securitizations, utilize derivatives to hedge interest rate and/or currency risk in the transaction. Alignment between a structured transaction and a related derivative will help to minimize value transfer upon the occurrence of a trigger event. To the extent a transaction includes a pre-cessation trigger, but its related hedge does not, or vice versa, the occurrence of such a pre-cessation trigger event may increase basis risk.

Subject to the concerns discussed below of certain SFA members regarding derivatives related to legacy structured finance transactions, SFA generally supports ISDA's proposal to include pre-cessation triggers in the amendments to the 2006 ISDA Definitions. As further discussed below,

some SFA members feel that it is important for the opt in approach be included in such amendments. Such SFA members have indicated that the ability to allow users to decide whether to opt in to the inclusion of the pre-cessation trigger in certain derivatives would help to create alignment between structured transactions and their related derivatives while also minimizing disruption to users of derivatives that are not similarly tied to a structured finance transaction.

Furthermore, such SFA members believe that such an opt in protocol could help to minimize misalignment in situations where the cash product or related structured finance transaction either includes or does not contain a pre-cessation trigger. Relatedly, some SFA members have indicated that for both existing derivatives and for new derivatives tied to a legacy structured finance transaction, the inclusion of a pre-cessation trigger without the ability to opt in or opt out of the application of such trigger may prevent such parties from adhering to the protocol due to concerns that the related legacy structured finance transaction would not include a similar trigger, and that misalignment could therefore result from adopting the protocol.

On the other hand, other SFA members have indicated that the value added by including this type of optionality may be outweighed by the increased complexity that would be caused by adding an opt in feature to the protocol, and have additional concerns as further discussed below. These members have indicated that such complexity may result in an overall lower adoption rate for the protocol. As such, these SFA members, while still in favor of the pre-cessation triggers being included, would not be in favor of including an opt in feature to the amendments.

As an alternative, ISDA could potentially publish a protocol including pre-cessation triggers and related fallbacks that allows adherents to (a) exclude certain transactions, (b) only include certain transactions, (c) require both counterparties to agree to include the pre-cessation trigger and related fallback through a "matching" function and/or (d) allow both counterparties to agree to exclude the pre-cessation trigger and related fallback through a "matching" function. Additional variations of the foregoing may also be possible. Any amendments made pursuant to such a protocol would apply in addition to the permanent cessation triggers and ISDA IBOR fallbacks and would be implemented in a way that does not add optionality to inclusion of those fallbacks upon the occurrence of a permanent cessation of a Covered IBOR in existing transactions between adhering parties.

Question 11: *Would such a protocol be helpful to address concerns regarding 'non-representative' benchmarks? If so, which of the approaches listed above (and/or variations of these approaches) do you prefer?*

Question 12: *Please comment on the relative disadvantages and advantages of such a protocol as compared to inclusion of a pre-cessation trigger in the 2006 ISDA Definitions and the protocol that ISDA intends to publish to implement the IBOR Fallbacks without any ability to elect for or against inclusion of such a pre-cessation trigger.*

Question 13: *Would you prefer using such a protocol as opposed to template language for bilateral incorporation in derivative contracts to address concerns regarding 'non-representative' benchmarks, and other pre-cessation concerns you may have?*

Question 14: *Do you have any other suggestions for flexible solutions to include pre-cessation triggers and corresponding fallbacks in derivative contracts on a voluntary basis that are less burdensome than template language for bilateral incorporation?*

Response to Questions 11-14:

As discussed above, SFA membership is concerned about possible misalignment between a structured transaction and its related derivative. However, SFA members disagree about whether the benefits of including the ability to opt in to the applicability of the pre-cessation triggers may be outweighed by the complexity such an approach might add. Those SFA members in favor of the opt in approach have indicated that that such a protocol will help to reduce risks of misalignment and would work to minimize the impact of these changes to users of derivatives that are not tied to a structured transaction. In the event the opt in approach is adopted, users of such derivatives that do not opt into such protocol could indicate that only the standard index cessation triggers previously promulgated by ISDA would apply. These SFA members have indicated that this would work to minimize impact and confusion for many derivative users.

On the other hand, other SFA members raised significant concerns that such an approach may decrease the number of parties adopting the new protocol. They believe that there is substantial benefit to having the market widely adopt these new protocols and fear that fewer parties adopting the protocols could have deleterious effects on the derivatives market overall. These members have further indicated that including optionality in the protocol will decrease the likelihood that the pre-cessation trigger is adopted, increase complexity, and reduce protocol adherence levels overall. In their opinion, a standardized protocol solution without optionality/flexibility is the most efficient approach and the least likely to create systemic risk Therefore, these parties would not be in favor of an opt in approach being adopted.

Additionally, as discussed above, SFA favors an approach that first looks to a forward-looking term SOFR. We recommend that ISDA consider having the replacement rate determined by first looking to the applicable forward-looking term rate, if available, and then to an averaged or compounded overnight RFR, in each case plus an applicable spread. Similarly, those SFA members in favor of the optin approach with respect to the pre-cessation triggers indicated that an opt in approach may also be useful with respect to the inclusion of term SOFR in the protocol.

If the Covered IBOR continues after counterparties convert to the adjusted RFR plus a spread, the counterparties would be able to determine whether they are receiving/paying more or less on the basis of the adjusted RFR plus the spread by comparison with the unrepresentative Covered IBOR that continues to be published.

Question 15: *Would it be appropriate to use the adjusted RFR plus a spread under these circumstances or could it be problematic? Please explain.*

Question 16: *Is there a way to mitigate against any concerns regarding the fact that counterparties could determine this?*

Question 17: *If you would not want to replace references to the Covered IBOR with references to the adjusted RFR plus a spread under these circumstances, what other amendments to existing derivative contracts would you want to make following such a statement?*

Response to Questions 15-17: Generally, we believe that performance of a benchmark after a trigger event should not be considered in any spread adjustment or other transition determinations. One of SFA's primary concerns in all matters related to LIBOR cessation is the minimization of the transfer of value between parties in a transaction. However, the determination of value transfer should be determined as of the date of transition to an adjusted RFR. In derivatives generally and in other bilateral contracts that can be readily amended, the parties can contractually agree to transition to an adjusted RFR on mutually agreed terms, and such agreement should not be affected by the subsequent performance of the IBOR after the transition date.

Notwithstanding the above, there may be situations where parties to a derivative would be willing to transition to a successor rate following a pre-cessation trigger, but the related structured finance transaction cannot be amended to provide for adoption of a successor rate on such pre-cessation event. For example, this could occur in a legacy transaction where consent of each bondholder would be required to implement such changes. Similarly, parties may wish to enter into a new derivative with respect to an existing structured finance transaction that does not contain a pre-cessation trigger. In such transactions, in the event that there is a pre-cessation trigger event but LIBOR continues to be published thereafter, the inability to opt in or opt out of the pre-cessation trigger for the derivative could introduce misalignment. These are additional reasons why some SFA members believe that the opt in protocol discussed above should be adopted. Such members have indicated that, if the opt in approach were adopted, in an instance where a derivative is hedging a structured finance transaction that cannot be amended and the relevant IBOR continues to be published, the parties to the related derivative could decide not to have the pre-cessation trigger protocol apply to the derivative linked to such structured finance transaction.

If the supervisor of the administrator made a statement that a Covered IBOR is no longer representative and, as a result, derivative contracts are amended to reference the adjusted RFR plus a spread calculated by reference to historical data at the time the relevant regulator makes such a statement, and the Covered IBOR is subsequently permanently discontinued following an 'index cessation event' (as set out on pages 2 to 3 above), the spread that would apply for the permanent cessation fallbacks would differ from the spread that applied for the pre-cessation fallbacks (i.e. because the spread would be fixed at different times by reference to historical data available, in the case of the pre-cessation trigger, when the non-representativeness statement is made and, in the case of the permanent cessation trigger, when the statement regarding permanent cessation is made).

Question 18: *In this scenario, should the spread adjustment following permanent discontinuation of the Covered IBOR automatically change to the 'permanent cessation' spread (i.e., a spread calculated by reference to historical data at the time the announcement is made in respect of permanent cessation)? Alternatively, should it remain at the spread adjustment for the 'pre-cessation' event?*

Question 19: *Would it be problematic to have multiple spread adjustments apply based on when the fallbacks took effect (i.e., prior to cessation or upon cessation)?*

Question 20: *If adherents to a protocol of the type described in questions 11-14 above exclude a pre-cessation trigger for fallbacks in certain contracts and/or with certain counterparties, should they agree that the spread adjustment related to the pre-cessation trigger would nevertheless apply if a permanent cessation occurs?*

Response to Questions 18-20: We believe that the spread adjustment with respect to any RFR should be set at the time of the first trigger event and any subsequent changes to the applicable IBOR should not be considered. This is similar to the approach set forth in the Green Paper. The benefit to this approach is in its simplicity. After a trigger event has occurred, parties would not need to continually monitor the previously applicable IBOR. Operationally, this may be useful for parties that have many outstanding derivative transactions. Additionally, in the event of a pre-cessation trigger followed by an ultimate cessation trigger, the behavior of the relevant IBOR between such triggers may be different from historical norms because of the occurrence of the pre-cessation trigger. As noted above, LIBOR has spiked considerably in times of financial stress. We assume that following a pre-cessation trigger an IBOR may similarly perform erratically. Since the spread adjustment will be determined on the basis of historical data, the best available data at the time of transition should be used.

We recommend that the ISDA protocol provide that in the event that the pre-cessation triggers apply to any derivatives, for such transactions the spread should be determined as of the date of the occurrence of a pre-cessation trigger and that subsequent changes in the relevant IBOR will be disregarded. Those SFA members in favor of the opt in approach have also noted that while this creates the possibility that transaction parties will have different spreads for certain of their transactions (i.e., if such parties opt in to the pre-cessation triggers applying to only a subset of their derivatives), they feel this complication is outweighed by avoiding any confusion as to what spread should be used for a specific transaction.

SFA appreciates your consideration of these comments and welcomes the opportunity to discuss further. If you have any questions about this matter, please contact Sairah Burki, Head of Policy, at (202) 524-6302 or sairah.burki@structuredfinance.org.

Very truly yours,

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