March 25, 2020

Via email to the ARRC Secretariat at: arrc@ny.frb.org

Alternative Reference Rates Committee, convened by the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York

Re: ARRC Consultation on Spread Adjustment Methodologies for Fallbacks in Cash Products Referencing USD LIBOR

The Structured Finance Association ("**SFA**") appreciates the opportunity to respond to the Consultation ("**Consultation**") of the Alternative Reference Rates Committee ("**ARRC**") regarding Spread Adjustment Methodologies for Fallbacks in Cash Products Referencing USD LIBOR.

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 an important step in the overall process of transitioning globally from LIBOR to new benchmarks representing market-based risk-free rates. The Consultation seeks commentary on the appropriate spread adjustment methodology the ARRC should recommend as part of its fallback provision recommendations for cash products referencing LIBOR and asks specific questions relating to such methodologies ("Questions"). The Consultation seeks commentary from all market participants.

As you know, SFA is a member of ARRC and we also serve as co-chair of the ARRC Securitization Working Group. In an independent effort, we convened our LIBOR Task Force in early 2018 to identify 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.

Submitted below, are SFA's responses ("Responses") to each of 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. Please note that since Questions 8 through 11 relate to consumer products, we have declined to answer such questions. Capitalized terms that are used in this letter, unless otherwise defined, have the meanings set forth in the Consultation.

Question 1: *Do you agree that using the ISDA methodology of a 5-year median of the historical difference between LIBOR and the SOFR fallback rate is the best choice for the following cash products, or would you prefer an alternative method?*

Floating Rate Notes	☐	*5-year median is preferred*	☐	*Other method is preferred*
Securitizations	☐	*5-year median is preferred*	☐	*Other method is preferred*
Syndicated Loans	☐	*5-year median is preferred*	☐	*Other method is preferred*
Bilateral Business Loans	☐	*5-year median is preferred*	☐	*Other method is preferred*

Response to Question 1:

Given the composition of SFA's membership, our response to Question 1 is limited to securitizations only. Generally, we believe that consistency across different products and asset classes would be extremely beneficial to the industry as a whole. In SFA's February 2019 response to the ARRC's Consultation on New Issuance of LIBOR Securitizations, SFA indicated that we supported using the longest possible lookback period in calculating a spread adjustment.[1] At that time, we also indicated that a lookback period of at least ten years would be ideal. However, members believe that there is significant value in the securitization industry aligning with the spread adjustment methodologies used by other key market participants, including ISDA. As such, we currently support the use of the 5-year median methodology in calculating the LIBOR-SOFR spread adjustment. To the extent ISDA or the industry coalesces around a different methodology (e.g., the use of a longer lookback period, or if the market participants supported the use of a dynamic spread adjustment as opposed to a static adjustment), SFA would reevaluate its support for the 5-year median method.

[1] Available at https://structuredfinance.org/wp-content/uploads/2019/05/SFIG_Response_to_ARRC_Consultation_New_Issuances_of_LIBOR_Securitizations_2.5.19.pdf

Question 2: *If "Other Method" was specified for any product, please provide additional feedback on your institution's preferences, noting whether your alternative is strongly or mildly preferred and why you prefer the alternative method:*

a. 5-year trimmed mean
b. 5-year average
c. 10-year median
d. 10-year trimmed mean
e. 10-year average
f. 3.5-year median
g. 3.5-year trimmed mean
h. 3.5-year average
i. Other (please specify)

Response to Question 2:
Not applicable.

Question 3: *If there are fewer than 5 years of available data to use in calculating a spread adjustment for a forward-looking term rate, which method would you prefer to calculate the associated spread adjustment:*

a. Use the longest span of indicative term rate data available
b. Use the spread adjustment associated with the difference between LIBOR and a compound average of SOFR in arrears as an appropriate spread adjustment for the forward-looking term rate
c. Use the spread between LIBOR and EFFR OIS rates, adjusted for the mean difference between compound averages of EFFR and SOFR.

Response to Question 3:
As indicated in our response to Question 1 above, we believe there is significant value in aligning various methodologies across products and asset classes. As a result, we currently support option (b) above as the data source for the period of time prior to when indicative term rate data is available, given that we understand ISDA has indicated it will use a similar approach in calculating the applicable spread adjustments. As noted in the response to Question 1, our support for such an approach may need to be reevaluated to the extent the industry moves towards a different methodology, such as a dynamic spread adjustment.

Question 4: *Do you believe that a 1-year transition period should be included for any of these cash products? If yes, please specify which products. (If you believe that a transition period should be included, but that it should be longer or shorter than 1 year, please note this and explain why.)*

Response to Question 4:
We believe that the implementation of a 1-year transition period may add unnecessary complexity to the LIBOR-SOFR transition. Additionally, we understand that ISDA does not currently support such a transition period. As such, we do not support the use of a 1-year transition period for cash products.

Question 5: *Should the ARRC recommend spread adjustments for 1-week or overnight LIBOR?*

Response to Question 5:
SFA membership has indicated that neither 1-week LIBOR nor overnight LIBOR are frequently utilized as a reference rate in securitizations. Most securitizations tie the LIBOR tenor to be used to the length of time between payments made on the securities. As such, SFA membership indicated that the shortest commonly-used tenor in securitizations is 1-month LIBOR. Accordingly, we do not recommend that ARRC produce spread adjustments for 1-week LIBOR or overnight LIBOR, from the perspective of the securitization market.

Question 6: *Should the ARRC recommend spread adjustments based on the differences between LIBOR simple averages of SOFR in addition to compound averages?*

Response to Question 6:
SFA membership has indicated that there have been a number of new-issue transactions that have used a simple average of SOFR as the reference rate. Additionally, it is not yet clear whether future new issue securitizations that use SOFR will use the simple average or compounded average convention. As you know, while ISDA leans towards compounded SOFR, the ARRC-recommended securitization fallback language indicates market participants may elect to use simple average SOFR. To the extent there is a marked difference between the spread adjustment calculated using a simple average SOFR and a compound average SOFR, parties may prefer that for transactions that rely on simple average SOFR there is a separate adjustment calculation based on the difference between LIBOR and simple average SOFR. On the other hand, certain SFA members have questioned whether the added complexity of publishing two sets of spread adjustments outweighs the possible mismatch a transaction might face using a spread adjustment based on compounded average SOFR, if the reference rate for the transaction was based on a simple average SOFR. Furthermore, there remain questions with respect to whether participants in legacy transactions that transition to SOFR will choose to use the simple average or compound average convention. Such decision may be driven by the transaction party making such decision, contractual constraints within the securitization documentation, as well as the composition of the underlying collateral.

Question 7: *Would it be problematic to use different approaches to calculate the spread adjustment across products and currencies? Please comment specifically on the implications of any differences in the recommended spread adjustment methodologies.*

Response to Question 7:
As previously indicated, we think there is a substantial benefit to having alignment between products and asset classes as to how spread adjustment methodologies are calculated. With respect to securitizations, one concern voiced by SFA membership has been that for cash products that include a derivative, or that are hedged with a derivative, misalignments between the cash product and derivative fallback provisions (including the applicable spread adjustments) may have unanticipated economic consequences. Alignment across various products, asset classes and currencies should decrease the risk of any value transfer.

Question 12: *Please provide any additional feedback on any aspect of the proposals.*

Response to Question 12: As we have indicated in our above responses, we strongly support consistency across various products and asset classes in the transition from LIBOR to successor reference rates, wherever possible. As such, as a general matter we feel that alignment with ISDA on LIBOR-succession issues would be extremely beneficial to the securitization market. That said, securitizations backed by floating rate assets present specific challenges that are not encountered with derivatives.

One of the key factors that will ultimately determine which LIBOR-succession provisions will be adopted in both new and legacy securitization transactions is how the underlying collateral (if floating rate) will address LIBOR succession. Such decisions will also be illustrative in determining which spread adjustments may be necessary. Ideally, the transition from LIBOR to an alternative reference rate would not change the value of outstanding securities. This goal would be best served by alignment between the LIBOR-succession provisions in the pool of collateral and the securitization – both with respect to the selection of the successor reference rate (along with the related conventions) and the time when such provisions went into effect. Because different underlying assets could adopt different conventions, it is uncertain how a securitization could best match the provisions of the underlying pool in its definition of the interest rate on the securities, so as to minimize any transfer of value between different classes of securities in the securitization transaction. In light of this uncertainty, it may be necessary in the future to consider different conventions for deriving a SOFR-based reference rate, which may give rise to a need for different types of spread adjustments.

SFA appreciates your consideration of these comments and welcomes the opportunity to discuss further. If you have any questions about this matter, please contact Kristi Leo, President, at (917) 415-8999 or Kristi.Leo@structuredfinance.org.

Very truly yours,

Kristi Leo
President
Structured Finance Association