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August 29, 2022

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

Via electronic email

RE: Proposed Rule: Regulation Implementing the Adjustable Interest Rate (LIBOR) Act[1] (Docket No. R–1775, RIN 7100–AG34)

Dear Ms. Misback,

SOFR Academy[2] commends the significant amount of work conducted by the Board of Governors of the Federal Reserve System (**"Board"**) and its' representatives over the last decade in connection with the London Interbank Offered Rate ("**LIBOR**") transition.

The successful[3] and orderly transition away from LIBOR to robust reference rates such as the Secured Overnight Financing Rate ("**SOFR**") is an excellent example of the public and private sectors working together in collaboration towards a common goal. We note the broad bipartisan support[4] for a legislative solution as demonstrated by the passage of the Adjustable Interest Rate (LIBOR) Act of 2021 ("**LIBOR Act**").

[1] https://www.govinfo.gov/content/pkg/FR-2022-07-28/pdf/2022-15658.pdf
[2] SOFR Academy, Inc. provides financial education and market information to empower corporations, financial institutions, governments, and individuals to make better decisions. The Firm's panel of advisors includes academics from Harvard University, the University of California Berkeley, New York University, the University of Oxford, London Business School and Tsinghua University, as well as experienced financial services professionals. SOFR Academy is a member of the Asia Pacific Loan Market Association (APLMA), American Economic Association (AEA), the Loan Syndications and Trading Association (LSTA), the International Swaps and Derivatives Association (ISDA), the Bankers Association for Finance and Trade (BAFT) which is a wholly owned subsidiary of the American Bankers Association (ABA), and the U.S. Chamber of Commerce (USCC). For more information, please visit www.SOFR.org.
[3] Significant progress has been achieved in the shift away from LIBOR to SOFR in new activity across markets – See ARRC July meeting minutes: https://www.newyorkfed.org/medialibrary/microsites/arrc/files/2022/arrc-meeting-minutes-july-13-2022
[4] https://clerk.house.gov/Votes/2021407

SOFR Academy appreciates the opportunity to comment on the Board's proposal that provides default rules for certain contracts that use the LIBOR reference rate, which will be discontinued next year. We strongly support[5] the LIBOR Act as well as the Board's notice of proposed rulemaking associated with the Act's regulatory implementation. It is a vital step towards smoothing the transition from LIBOR and preventing disruption, uncertainty and harm to American businesses and financial markets.

We respectfully share some concern with the fixed credit spreads included in the Act. Should the fixed credit spreads in the LIBOR Act differ even marginally to market-based credit spreads at the time of LIBOR cessation, this could result in a "cliff-edge"[6] event for non-consumer products with significant and avoidable value transfer which could give rise to market confusion and conflicts of interest that could adversely impact American businesses. Moreover, in the event that there is a material difference between market-based spreads and the fixed historical spreads in the Act there could be potentially adverse financial stability implications given the collective notional size[7] of "existing contracts that reference USD LIBOR, will not mature by June 30, 2023, and cannot be easily amended."[8]

The fixed credit spreads for US dollar LIBOR which were crystallized on March 5, 2021, based on five-year lookback period differences between the underlying benchmarks, were set before the full economic impact of Covid-19 was realized, which had a material effect on interest rate and credit spread pricing[9].

One potential approach may be that the Board's final rule could identify a particular SOFR-based rate for certain categories[10] of LIBOR contracts that includes a contemporaneous credit spread supplement that is based on prevailing market conditions closer to the time of cessation. This would help to reduce market friction and inefficiencies associated the implementation of the LIBOR Act.

For consumer products, the Alternative Reference Rates Committee recommended a gradual move to the spread or difference calculated over a five-year lookback period to avoid sudden

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[5] https://sofracademy.com/sofr-academy-welcomes-passage-of-libor-transition-bill-by-u-s-house-of-representatives/
[6] https://www.risk.net/derivatives/7889766/dealers-fear-operational-cliff-edge-when-libor-disappears
[7] Estimated notional value of impacts contracts has been reported to be in the vicinity of $16 trillion https://www.wsj.com/articles/congress-passes-legislation-on-libor-fix-as-part-of-1-5-trillion-spending-package-11647017063?mod=hp_minor_pos8
[8] https://www.govinfo.gov/content/pkg/FR-2022-07-28/pdf/2022-15658.pdf
[9] Clarida, Richard H., Burcu Duygan-Bump, and Chiara Scotti (2021). "The COVID19 Crisis and the Federal Reserve's Policy Response," Finance and Economics Discussion Series 2021-035. Washington: Board of Governors of the Federal Reserve System, https://doi.org/10.17016/FEDS.2021.035.
[10] Section 104(e)(1) of the LIBOR Act states does not state, for example, that "for each LIBOR contract that is not a consumer loan" - instead, it states "for each category of LIBOR contract that the Board may identify."

jumps in the rates paid by the borrowers. A recent NERA Economic Consulting paper[11] by Dr. Faten Sabry, Dr. Ignacio Franceschelli, and Ramisa Roya states:

> *"the methodology chosen for the spread adjustment of adjustable loans will have direct effects on various parties, including borrowers, lenders, investors, and intermediaries, and could lead to conflicts of interest".*

Applying the fixed credit spreads to consumer products could result in unfair outcomes for borrowers because mortgages prices are based on the contemporaneous values of the benchmark indices and not their values over a historical time period. A generally agreed upon theme in connection with LIBOR transition is that American consumers, businesses and borrowers should not be left worse off as a result of the transition.

Considerations for the identification of a Board-selected SOFR-based benchmark that includes a contemporaneous credit spread supplement

SOFR Academy believes that the Board could consider a principles-based approach when considering the identification of a SOFR-based index that includes an adjustment reflective of prevailing credit market conditions. Such considerations might include the following:

1. The index should be calculated and administered by an experienced benchmark administrator overseen by a financial market regulator. The benchmark administer should operate a governance, control and oversight environment in alignment with International Organization of Securities Commissions' (IOSCO) Principles for Financial Benchmarks[12]. This should be validated through an independent review conducted by an external audit firm with requisite experience in financial benchmarks.

2. The index must be able to be computed in several variations, just as SOFR can be, to account for the different needs of various market segments and across cash products and derivatives. This should include an overnight rate (sometimes referred to as "simple daily") which can be compounded in arrears or in advance, or as averages, in addition to a forward-looking term rate. The availability of an overnight credit spread adjustment allows for using in conjunction with SOFR compounded in arrears.

3. The index design should maximize the number of underlying transactions. The index should not be able to be manipulated by bad actors and should be fully transaction based. Input data should come from transactions that are publicly reported to engender credibility and trust in the index.

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[11] See "How Will the LIBOR Transition Affect Mortgage Consumers?" available at https://www.nera.com/publications/archive/2022/how-will-the-libor-transition-affect-mortgage-consumers-.html#:~:text=The%20London%20Interbank%20Offered%20Rate,lenders%2C%20investors%2C%20and%20intermediaries.

[12] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf

4. The design of the index should properly address concerns previously publicly expressed by financial market regulators in connection with credit sensitive rates. For example, the index should not use executable quotes as input data, should avoid complex regression calculations and should not be primarily reliant on commercial paper and certificates of deposit.[13]

5. The index should automatically adapt to future changes in market structure or regulation so that index robustness and representative are maintained into the decades ahead.

6. The index should be published on a publicly available website and available for usage.

We would welcome the opportunity to work with the Board, as well as other regulators and policymakers, in the event that the Board considers selecting a particular SOFR-based rate for certain categories of LIBOR contracts that do not include the fixed spread adjustments.

We appreciate the opportunity to submit our response to the request for comment.

Yours sincerely,

Marcus A. Burnett
CEO, SOFR Academy, Inc.

[13] See 'Prepared Remarks Before the Financial Stability Oversight Council', June 11, 2021, U.S. Securities and Exchange Commission, Chair Gary Gensler, available at: https://www.sec.gov/news/public-statement/gensler-fsoc-libor-2021-06-11