The Working Group on
Sterling Risk-Free Reference Rates

BY EMAIL

Umesh Gajria
Bloomberg LP
731 Lexington Avenue
New York
NY 10022
United States

6 January 2021

Dear Mr Gajria,

Supporting transition in sterling cash markets – use of Bloomberg's Fixed Fallback Spread Adjustment

I am writing to you on behalf of the market-led Working Group on Sterling Risk-Free Reference Rates ("**Working Group**"). It is recognised by the Working Group that Bloomberg Index Services Limited ("**BISL**"), following selection by ISDA, is very helpfully calculating and making broadly available to market participants certain adjustments related to risk-free rates ("**RFRs**") for their use in IBOR fallback arrangements and that this includes calculation of the historical credit adjustment spread (often abbreviated to the 'CAS', 'Bloomberg CAS' and 'BISL CAS', but referenced herein as the "**Fallback Spread Adjustment**"). We note BISL is publishing adjusted RFRs and all-in fallback rates in this capacity as well.[1] The Fallback Spread Adjustment is understood to be based on the ISDA historical five-year median spread adjustment methodology (the "**ISDA Methodology**") and is currently being published daily on an indicative basis prior to the setting of the Fallback Spread Adjustment on the occurrence of a cessation or pre-cessation trigger event (the "**Indicative Fallback Spread Adjustment**"); upon such an event, the Fallback Spread Adjustment will be fixed (the "**Fixed Fallback Spread Adjustment**").

For cash market products referencing GBP LIBOR, the Working Group recommended[2] in September 2020 use of the ISDA Methodology to calculate the credit adjustment spread that is to be applied to any relevant SONIA rate pursuant to contractual fallback and replacement of screen rate provisions, when GBP LIBOR permanently ceases or on a GBP LIBOR pre-cessation event.[3] In addition to this, some parties in the sterling cash markets (particularly in the loan market) have been considering the use of the ISDA Methodology for active transition to risk-free rates, i.e. before LIBOR ceases or a pre-cessation event occurs. In this case, a credit adjustment spread may be applied as at the date of the transaction or when the switch to the RFR occurs. It should be noted that other approaches to an active transition credit adjustment spread are also being considered in the sterling cash markets and the approach used is for market participants to decide on a case-by-case basis. To support market understanding of these approaches in the loan market, the Working Group has published a paper on "Credit adjustment spread methods for active transition of GBP LIBOR referencing loans".[4]

The Working Group recognises that, before a cessation or pre-cessation trigger event has occurred, market participants cannot use BISL's Indicative Fallback Spread Adjustment or the all-in rate which relies on it as a primary reference rate within a financial instrument or financial contract (as such terms are referred to in the Benchmark Regulation[5] or similar applicable frameworks). This is clear from the terms of Bloomberg's IBOR Fallback Rate Adjustments Rule Book. Once the Fixed Fallback Spread

[1] Where the adjusted RFR is calculated by the RFR being compounded in arrears, and where each all-in fallback rate is calculated using the adjusted RFR plus the Fallback Spread Adjustment.

[2] Based on the Working Group's Summary of Responses to the consultation on credit adjustment spread methodologies for fallbacks in cash products referencing GBP LIBOR.

[3] This recommendation is consistent with that of the US Alternative Reference Rates Committee for cash products referencing USD LIBOR. Where the recommendations of the two groups differ is that the Working Group has not suggested a different approach for retail loans.

[4] Credit adjustment spread methods for active transition of GBP LIBOR referencing loans.

[5] Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014.

Adjustment is available, however, we understand market participants may wish to use this as the primary reference rate within their financial instruments and financial contracts to facilitate active conversion away from GBP LIBOR.

We are aware that the Fallback Spread Adjustment data is available through various distribution channels (with a licence required from Bloomberg for immediate access, for the re-distribution rights or for usage of the Fallback Spread Adjustment) and is made publicly available on the Bloomberg website on a delayed basis. We also note the very helpful IBOR Fallbacks Fact Sheet, which, while understandably targeted at the derivatives market and use in ISDA documentation, also states that the Fallback Spread Adjustment is available for use in fallbacks in cases not covered by Supplement 70 to the 2006 ISDA Definitions. Given alignment of the Working Group recommendation with the ISDA Methodology, and the potential for some market participants to use the methodology for transition in sterling cash markets, the Working Group aims to facilitate a better understanding of the access (and the basis of such access) of cash market participants to the Fixed Fallback Spread Adjustment. Your response to the below questions would be most appreciated.

1. Can you confirm that the Fixed Fallback Spread Adjustment will be available for use in contractual fallbacks and/or active conversion in the sterling cash markets where one or more parties subscribe to Bloomberg and, if so, where can the terms of use and/or licensing arrangements for cash market participants intending to use it be found?

2. If the Fixed Fallback Spread Adjustment is available for use in sterling cash markets, it would be helpful to understand the arrangements in these particular use cases:

    a. For cash market participants who subscribe to Bloomberg, how are these users expected to access the Fixed Fallback Spread Adjustment?

    b. For cash market participants who are not Bloomberg subscribers, how should these users access the Fixed Fallback Spread Adjustment? Is there a difference in the access arrangements between different types of users in the cash markets – for example borrowers and lenders in respect of loans, and issuers and investors in respect of bonds?

    c. Cash market vendors are also looking to access the Fixed Fallback Spread Adjustment (for example, for the purposes of calculators and loan systems). Please could you confirm if and how these cash market vendors can access and use the Fixed Fallback Spread Adjustment, and under what terms?

Given the importance of transition in sterling cash markets and to support transparency for all cash market participants, we would very much appreciate your engagement with us on these questions by way of open letter. If cash market participants are able to access and use the Fixed Fallback Spread Adjustment (subject to the terms specified by Bloomberg), it would be extremely helpful, particularly for end-users, if Bloomberg could also enhance the current IBOR Fallbacks Factsheet to provide further support on matters relevant to cash market participants.

I would be very happy to discuss this letter or any of the questions above before any formal response, so please do not hesitate to contact me. I look forward to hearing from you.

Sincerely,

Tushar Morzaria

Chair of the Working Group on Sterling Risk-Free Reference Rates