LIBOR Transition Update

Introduction

The transition of financial markets from USD LIBOR to the secured overnight financing rate (SOFR) has proven to be a complex process — not without some setbacks — but has been gathering momentum this year. For most market participants, the importance of this transition rests on the fact that LIBOR is used as a reference rate in contracts for mortgages, consumer loans, corporate debt, derivatives and other financial instruments, and thus is woven deeply into the fabric of the global financial system. From an investment standpoint, Voya is monitoring potential issues with the LIBOR transition on major asset classes.

LIBOR transition: current status of major asset classes

Asset Class	Legacy LIBOR	Alternative Rates
Money markets	Few legacy issues, mostly off LIBOR	Primarily SOFR, some corporates use BSBY
IG corporates	Financials moving off LIBOR	SOFR
Derivatives	USD LIBOR swaps and swaptions still trading	U.S. Treasury instruments, SOFR, BSBY, other ARRs
Agency RMBS (incl. CRTs) and CMBS	Legacy LIBOR issues still circulating, GSEs working on replacement indexes	SOFR, term SOFR, compound SOFR
Non-agency RMBS and CMBS	Remains a LIBOR market	Expected to move to SOFR
ABS	Mostly fixed rate, few floaters	Floaters using SOFR, other ARRs starting to appear
Agency RMBS derivatives	Mostly pegged to LIBOR	SOFR after Oct. 2020
CLOs	Remains a LIBOR market	SOFR or BSBY
Private credit IG	Mostly fixed rate, remains a LIBOR market	SOFR most likely ARR
CMLs	Mostly fixed rate, remains a LIBOR market	ARRs not yet defined
Private credit HY	Mostly fixed rate, remains a LIBOR market	Expected to move to SOFR
Senior bank loans	Remains a LIBOR market	Expected to move to SOFR

Abbreviation key: LIBOR = London interbank offered rate, SOFR = secured overnight financing rate, BSBY = Bloomberg short-term bank yield index, ARR = alternative reference rate, IG = investment grade, RMBS = residential mortgage-backed securities, CRT = credit risk transfer securities, CMBS = commercial mortgage-backed securities, ABS = asset-backed securities, CLO = collateralized loan obligations, CML = commercial mortgage loans, HY = high yield.

Progress toward SOFR has picked up since the announcement in March that non-U.S.-dollar LIBOR benchmarks will permanently cease, or cease being representative, by year-end 2021. Certain U.S. dollar LIBOR benchmarks will be available after that date but will be discontinued, or cease being representative, as of June 30, 2023 — for details, see Voya's May 2021 market insight "LIBOR Transition Recent Developments.[1]" Developments since the May insight are summarized below.

[1] Source: Voya Investment Management — https://individuals.voya.com/insights/market-insights/libor-transition-recent-developments.

Recent Developments

Interdealer swaps transition to SOFR

The Commodity Futures Trading Commission's Market Risk Advisory Committee (MRAC) Subcommittee on Interest Rate Benchmark Reform, as part of its "SOFR First" transition initiative, recommends that interdealer brokers replace U.S. dollar (USD) LIBOR linear swap trading with SOFR linear swaps on July 26, 2021.[2] For the purposes of SOFR First, USD linear swaps include outright swaps, swap spreads and curve trades.

Why it matters

This step is expected to cause swap trading among dealers, which accounts for a substantial share of overall trading in the interest-rate swap markets, to switch from LIBOR to SOFR. This switch should increase liquidity in SOFR derivatives trading and fulfill the Alternative Reference Rate Committee's (ARRC) market conditions so it can recommend the SOFR term rate.[3] (Also see "Expectation for recommended term SOFR this summer," below.)

Dealers still will be able to execute USD LIBOR linear swaps with clients, but we may see wider bid–ask spreads on such instruments if dealers can't hedge these positions in the interdealer market.

Recommended term SOFR expected this summer

At the ARRC's SOFR Symposium on June 8, Thomas Wipf, Chairman of the ARRC, said: "The linkage between the SOFR First and term SOFR is very tight. If we can deliver on SOFR First with the recommendation of the MRAC sub-committee, then I think the ARRC will be well positioned in days, not weeks, following that July 26 date to be able to endorse CME term SOFR."[4]

Why it matters

The June 8 announcement is welcome news and sounds a significantly more hopeful tone than the ARRC's March 23 announcement, which had cast doubt on the availability of a term rate recommendation in 2021. In light of Wipf's statements, term SOFR has more potential to arrive this summer and fulfill the market's desire for a forward-looking term rate for SOFR. The more specific timeframe helps clarify how the LIBOR to SOFR transition will unfold.

FSOC principals promote SOFR

At the Financial Stability Oversight Council (FSOC) Principals meeting on June 11, a number of principals made statements that encouraged the use of SOFR, urged participants to transition from LIBOR to SOFR now and pointed out the shortcomings of BSBY as an alternative to SOFR.[5]

Why it matters

We still appear to be heading for a multi-rate and multi-convention post-LIBOR environment; but the combination of SOFR's head start, the forthcoming term rate and cautionary warnings from the FSOC all serve to reinforce SOFR's likely role as the dominant LIBOR replacement rate.

SOFR transition timeline

2021

March 5: Confirmation of 2023 delay and announcement of spread adjustments

April 6: NY State LIBOR legislation signed into law

April 21: CME announces launch of term SOFR

May 21: ARRC selects CME as the provider of recommended term SOFR

July 26: Dealer-to-dealer linear swaps switch to SOFR

July or August: Expected ARRC recommendation of CME term SOFR

December 31: End publication of non-USD LIBOR and 1W/2M USD LIBOR

December 31: U.S. Federal Reserve and regulatory agencies will examine bank practices for safety and soundness issues if LIBOR contracts are created after year-end[6]

2023

June 30: End publication of USD LIBOR for all remaining tenors

[2] CTFC announcement, https://www.cftc.gov/media/6051/faq_SOFRFirstTransition060821/download. ARRC response, 20210608-arrc-release-supporting-mrac-announcement-final (newyorkfed.org).

[3] Source: ARRC market indicators, 20210506-term-rate-indicators-press-release (newyorkfed.org).

[4] Source: SOFR Symposium The Final Year-20210608 1342-1 (brightcove.net). Tom Wipf's remarks at 1:02:44.

[5] Source: ARRC recap, 20210615-arrc-release-fsoc-meeting-final (newyorkfed.org). BSBY criticisms, SEC.gov | Prepared Remarks Before the Financial Stability Oversight Council.

[6] Source: Statement on LIBOR Transition - November 30, 2020 (federalreserve.gov).

Voya's LIBOR transition program

Voya Financial has taken proactive steps to ensure that as a market participant, fund manager and counterparty, we are well-positioned to adapt to evolving market conventions, norms and benchmarks. In 2019, we established a comprehensive LIBOR transition program and governance structure, headed by the Voya Financial Risk Committee, with executive sponsorship from Voya Financial's CFO and Voya Investment Management's CEO. The program is chartered to manage the financial and non-financial risks related to LIBOR cessation across the entire Voya Financial organization. One of the most significant areas of focus of the project is the LIBOR exposure of LIBOR-based floating rate invested assets of Voya's proprietary subsidiaries and investment advisory clients. The LIBOR program includes project managers, AI investment analysis and workstreams dedicated to contract remediation, product transition, system and operational readiness, finance and client communications. Project managers and functional area business leads are coordinating these workstreams and their related interdependencies.

The program continues to actively monitor current market developments relating to LIBOR cessation from regulators, the ARRC, trade associations, dealers and market participants; as needed, Voya will adjust its transition program.

Integrated into the LIBOR program are a number of third-party vendors and services to provide market and legal expertise, project management support, fallback data analysis, back office services and application services.

Voya's actions to serve clients

In light of the recent developments, Voya will seek to:

- Maintain project momentum to be fully operational with SOFR and credit sensitive rate needs, across all investment asset classes, by year-end 2021
- Incorporate recent regulatory and legislative developments to address pending LIBOR cessation this calendar year, seeking to reduce risks and exposures by the end of 2021 to the extent practicable
- Support our clients, regulators or other interest parties throughout the LIBOR transition, keeping them apprised of new developments as appropriate

The Voya LIBOR cessation transition program continues to analyze the risks inherent in LIBOR exposures expected to be retained past 2021. We are embedding processes and controls to monitor and manage such exposures, tracking positions and testing scenarios for each line of business. In addition, we continue to monitor market and regulatory developments relating to LIBOR cessation, as well as LIBOR investments and products that are subject to fallback legislation.

Our approach remains pragmatic. We recognize that USD LIBOR will continue to be published until June 2023 and more legislative solutions are likely; therefore, we will not seek to close out every position. We will continue to evaluate where it's advantageous to take action or not for our clients and products, keeping a close watch on risk. We seek to stay nimble where there may be market impact, e.g., monitoring alternative reference rates outside SOFR that may be gaining traction.

Disclosures

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