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FINANCIAL SERVICES

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Options for Using SOFR in New ABS, MBS, and CMBS Products

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The Alternative Reference Rates Committee ("***ARRC***") convened by the Federal Reserve Board and the Federal Reserve Bank of New York, with the assistance of its Securitizations Working Group released a report (the "***Report***") on March 29, 2021 entitled "Options for Using SOFR[1] in New ABS, MBS, and CMBS Products." Out of awareness for the variety of structures, exposures and preferences of the market participants involved, the model presented does not deal with corporate collateralized loan obligation products. It also focuses on setting rates in advance, rather than at the end of an interest period (in arrears), although it does discuss some practical difficulties of fixing rates in arrears and promises fuller discussion of that type of rate setting in the future.

The rate which the Report treats as most promising is the 30-day Average SOFR,[2] for several reasons:

- It is already used in some US securitizations;
- A fairly substantial number of securitizations are collateralized by assets that require monthly payment and whose rates are set in advance;
- Setting rates in advance allows exposures to be more effectively hedged or traded;
- A 30-day average rate seems likely to reprice quickly enough to reflect most market fluctuations;
- Rate fluctuations for longer interest periods currently in use seem to be adequately reflected by using 30-day rates;
- Picking a usable and reasonable standard potentially reduces confusion in the securitization market;
- The rate is easily available from a trustworthy source; and
- It can be adjusted by adding an appropriate spread.

In addition, setting rates in advance is operationally easier than setting them in arrears, even though setting them in arrears more exactly matches the rates that actually are present in the market during the relevant period. Despite these considerations, the ARRC disclaims any intent to hinder or prevent the development of other products or procedures or to require the use of the 30-day Average SOFR, but it does encourage the use of workable solutions in preference to waiting for perfect ones. Given the great variety of relevant considerations. Market participants should both continue to observe the market's behavior as more transactions are structured using SOFR and, if they are able, conduct large-scale simulations to test alternatives that may not yet be marketable.

[1] Secured overnight financing rate, which is based on transactions in the Treasury repurchase market.
[2] The Report describes the formula used for calculating SOFR as well as the special weekend date conventions used.