



## Not SOFR Away: Leaving LIBOR Behind

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## I. Past

## What is LIBOR?

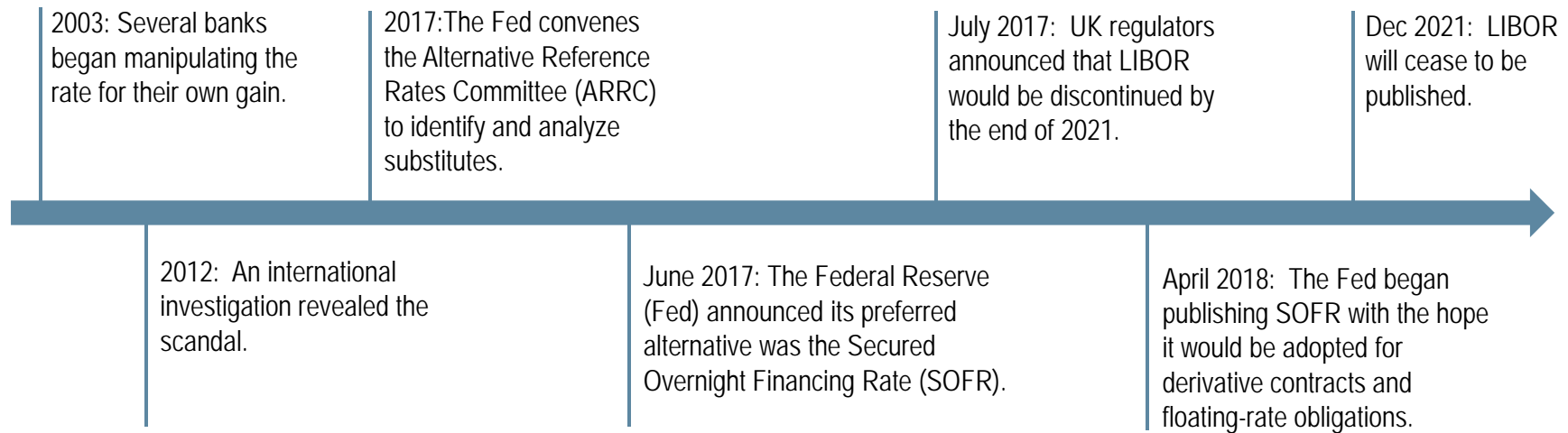
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The London Interbank Offered Rate, or LIBOR, is the most common benchmark interest rate index used to make adjustments to variable-rate loans. LIBOR is used by world banks when charging each other for loans over a short-term period.

- Five currencies: US dollar (USD), euro (EUR), pound sterling (GBP), Japanese yen (JPY) and Swiss franc (CHF)
- Maturities ranging from overnight to 1 year, with the most popular being 3 months
- Serves as benchmark for government and corporate bonds, mortgages, student loans and credit cards, as well as derivatives and other financial products
- Indicates risk in the interbank market. The greater the perceived risk of banks, the greater the amount they will charge each other for loans, leading to an increase in LIBOR

## Timeline to LIBOR's Demise

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## An International Effort

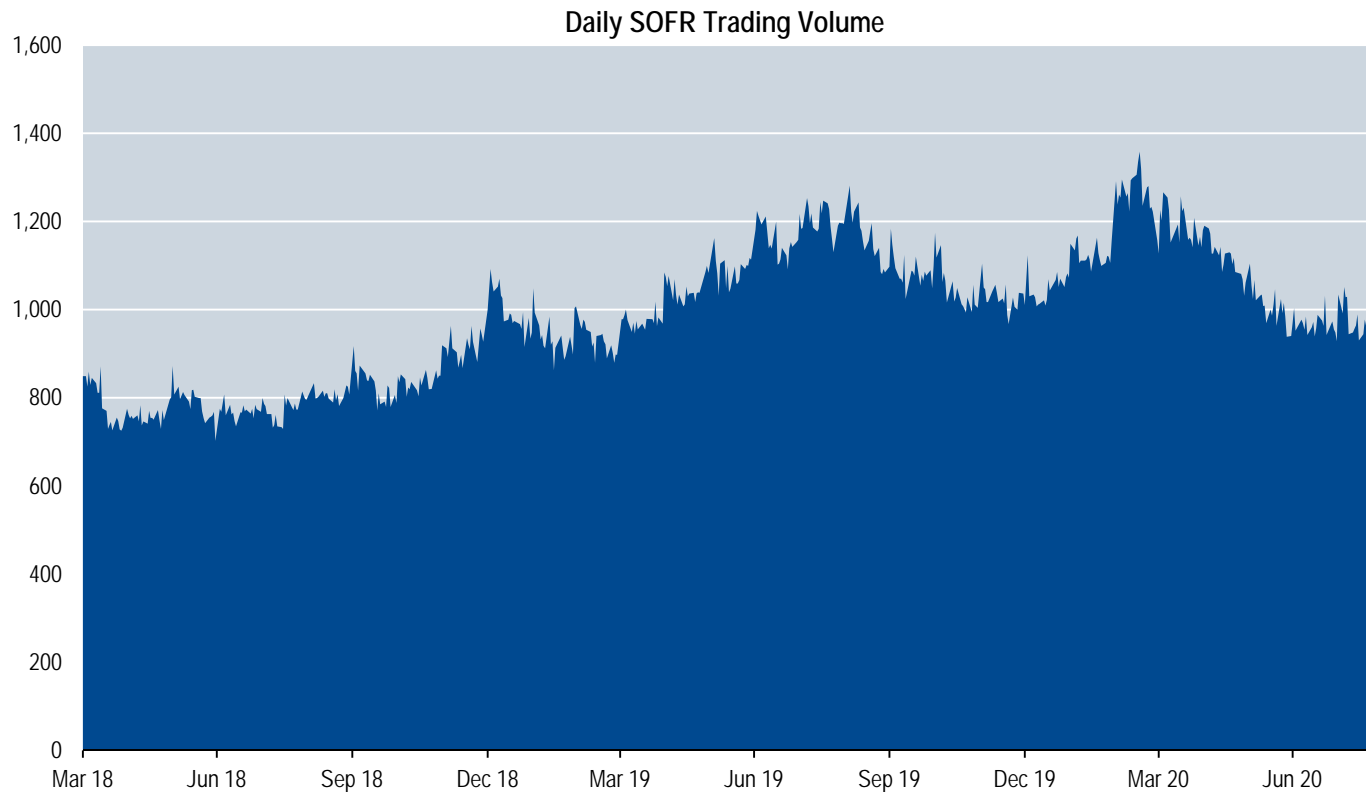
Jurisdiction	Working Group	Alternative Rate	Secured vs. Unsecured	Overnight vs. Term	Rate Administration	Publishing Since
US	Alternative Reference Rates Committee	Secured Overnight Financing Rate (SOFR)	Secured	Overnight	Federal Reserve Bank of New York	2018
UK	Working Group on Sterling Risk-Free Reference Rates	Reformed Sterling Overnight Index Average (SONIA)	Unsecured	Overnight	Bank of England	2018
Switzerland	The National Working Group on Swiss Franc Reference Rates	Swiss Average Rate Overnight (SARON)	Secured	Overnight	SIX Swiss Exchange	2009
Japan	Study Group on Risk-Free Reference Rates	Tokyo Overnight Average Rate (TONAR)	Unsecured	Overnight	Bank of Japan	1992
Eurozone	Working Group on Risk-Free Reference Rates for the Eurozone	Euro Short-Term Rate (ESTER)	Unsecured	Overnight	European Central Bank	2019

Source: Federal Reserve Bank of New York

## II. Present

## What is SOFR?

- Overnight rate based on US Treasury repo transactions
- SOFR is the cost of borrowing cash overnight while posting risk-free collateral
- Transactions applicable to SOFR now average over \$900 billion per day



Source: Federal Reserve Bank of New York

## Why Should People Care That LIBOR is Ending?

Over \$200 trillion in outstanding derivatives contracts and loans are based on US LIBOR

### US Dollar Transactions That Reference US LIBOR

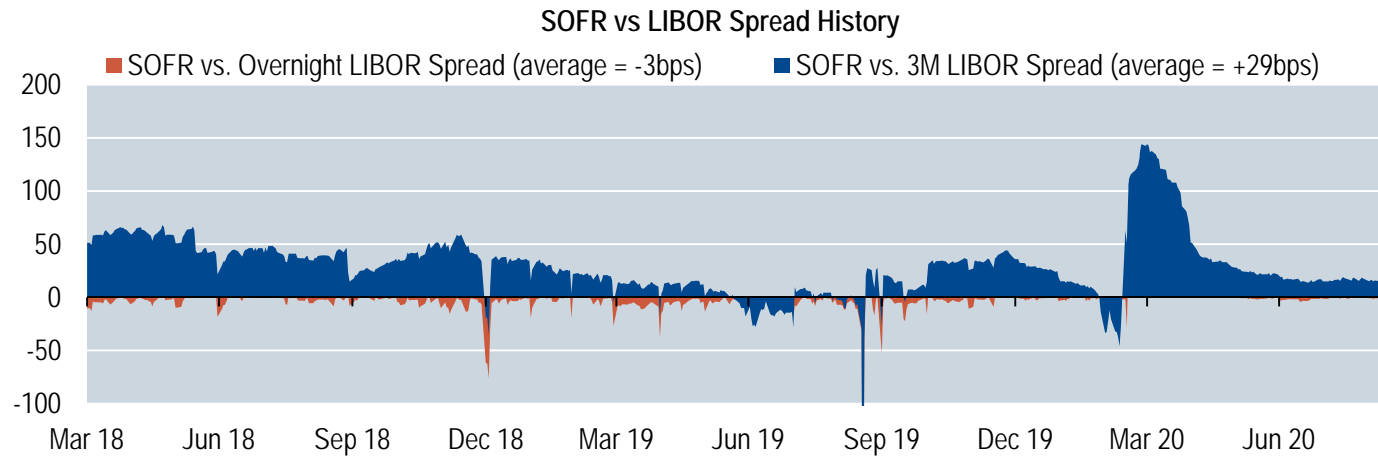
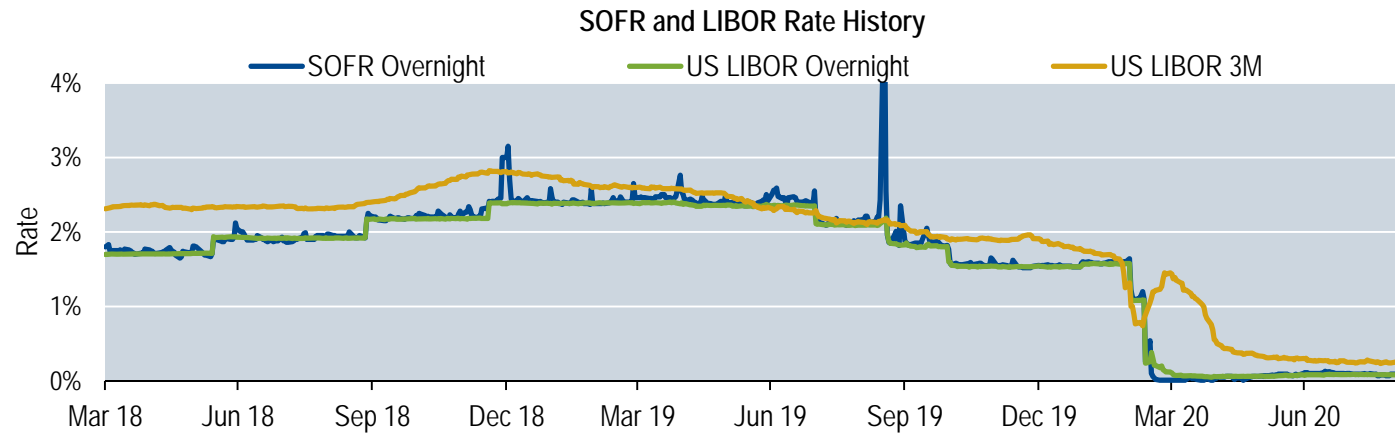
Financial Vehicle	Amount (in \$ Trillions)
Derivatives	\$190
Floating Rate Notes	\$1.8
Securitizations (ABS, CLOs, MBS)	\$1.9
Business Loans (Bank/Middle Market Loans/CMBS)	\$3.4
Consumer Loans (Mortgages/Student)	\$1.3
<b>TOTAL</b>	<b>\$200 (approx.)</b>

*Source: ARRC Report, March 2018*

Changing the reference rate on such a large pool of funds globally is very significant



# How Has SOFR Compared to LIBOR in the Past?



Source: Bloomberg

### III. Future

# The Likely Impact to LIBOR-Referenced Instruments After the Demise of LIBOR

- The transition will be easier for asset classes regulated by a central authority
- For more heterogeneous asset classes, the transition will be more complex

## US Dollar Transactions That Reference US LIBOR

Financial Vehicle	Pre-FCA Announcement Fallback Language	Post-FCA Announcement Fallback Language
Derivatives	Calculation agent polls bank, if unsuccessful uses last posted rate	SOFR is the replacement rate compounded in arrears + spread adjustment
Floating Rate Notes	Calculation agent polls bank, if unsuccessful uses last posted rate	Based on a waterfall (1) term SOFR + spread adjustment (2) SOFR compounded in arrears + spread adjustment
Securitizations	Last posted LIBOR rate	Servicer to amend successor rate
Business Loans	Last posted LIBOR rate, prime rate or discount rate	Based on a waterfall (1) term SOFR + spread adjustment (2) SOFR compounded in arrears + spread adjustment (3) administrative agent and borrower choose successor rate
Consumer Loans	Last posted LIBOR rate	Servicer to amend the successor rate

Source: Western Asset

## LIBOR and SOFR Used as a Performance Benchmark

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- LIBOR and similar short-term interbank rates are sometimes used as performance benchmarks for many portfolios, such as money market funds
- These types of benchmarks are used to signify
  - 1) the short-term and investment-grade nature of the investments
  - 2) a desire for a floating interest rate which resets on a regular basis
  - 3) a rate that compensates for the credit risk of counterparties such as banks
- For all of these reasons the popularity of LIBOR-based benchmarks has been steadily in decline since the global financial crisis
- Remaining portfolios with LIBOR based performance objectives will need to be restated, possibly to include a assumed spread
- This exercise will be even more critical where fees are also based on these objectives

## Summary

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- LIBOR will die and will not rise from the dead (no zombie LIBOR)
- Banks need to act in the best interest of their customers, and there is a huge global regulatory effort to ensure this takes place
- It's about preparation. Treasurers face similar challenges that affect market participants—namely identifying where in their contracts and treasury management system is LIBOR being used and trying to quantify what their exposure is to it
- The next step is to start agreeing amendments on those contracts and make sure that they behave as they are intended to when LIBOR goes away

## Risk Disclosure

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