

P.R.I.M.E. Finance

Panel of Recognized International Market Experts in Finance

Benchmark No More: The Case of the Disappearing IBORs



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REPLACING IBORs – Market Issues

- **Background – The RFRs directive from the FSB**
 - UK, SONIA (unsecured rate)
 - USA, SOFR (secured rate)
 - SWITZERLAND, SARON (secured rate)
 - JAPAN, TONA (unsecured rate)
 - EURO, ESTER (unsecured rate, coming out soon)
- **Market Reality**
 - Market participants want term (7, 30, 60, 90, 180 days)
 - Market participants also want a measurement of bank credit spread (the spread between bank risk and a risk free rate), in case LIBOR ceases to exist
- **Progress to Date**
 - Derivatives markets have developed forward (as opposed to arrears) term rates
 - The GBP swap market is most developed (both swap markets, and ICE/CME/LSE futures)
 - The US swap market shows signs of progress (basis market between SOFR and LIBOR, and traded futures in CME/ICE), but challenge much bigger
 - Credit spread estimates are required if LIBOR does not set anymore (fallback work). ISDA work attempts to address this (historical mean/median)
 - 3 month LIBOR still the preferred floating rate index
 - Work on fallback provisions continues



INTEREST RATE BENCHMARKS

ISDA Survey – Notional Amounts and Trade Counts

	Q4 2018		Full Year 2018	
	Traded Notional (US\$ billions)	Trade Count	Traded Notional (US\$ billions)	Trade Count
USD LIBOR	26,824.0	156,220	111,476.0	633,142
SOFR	3.6	21	3.8	24
Basis Swaps: SOFR	1.1	16	2.5	28
GBP LIBOR	2,353.8	19,381	9,809.6	78,098
SONIA	2,049.1	2,533	7,849.5	7,402
Basis Swaps: SONIA	55.3	252	134.1	813
CHF LIBOR	109.7	1,614	473.5	6,767
SARON	1.3	6	2.5	16
Basis Swaps: SARON	0.0	0	0.0	0
JPY LIBOR	918.7	10,417	3,546.5	37,293
TIBOR/Euroyen TIBOR	0.2	20	2.2	76
TONA	39.5	131	101.5	339
Basis Swaps: TONA	1.0	4	2.1	8
EUR LIBOR	0.0	0	2.9	60
EURIBOR	5,046.8	35,473	22,884.5	162,482
ESTER	0.0	0	0.0	0
Other*	19,516.9	95,139	80,122.7	398,569
Total	56,920.9	321,227	236,414.0	1,325,117

*Other includes IRD with other reference rates and IBOR/non-RFR basis swaps

Source: DTCC and Bloomberg SDRs

SECURED OVERNIGHT FINANCING RATE (SOFR)

- In the US, the Federal Reserve Bank of New York has taken the leadership in establishing alternatives to US LIBOR
- In 2014 it established the so called Alternative Reference Rates Committee (ARRC) - a group of market participants
- In June 2017, ARRC selected SOFR as its preferred alternative to U.S.-dollar LIBOR
- SOFR is the cost of borrowing overnight using U.S. Treasury securities as collateral
- SOFR is transaction-based, and the underlying market has daily volumes of more than \$700 billion
- CME (and ICE more recently) began offering SOFR futures contracts in May 2018
- Freddie and Fannie have issued SOFT denominated bonds in support of SOFR
- Most of these bonds are swapped back (with dealers) into 3 month LIBOR
- Basis market is illiquid