P.R.I.M.E. Finance
Panel of Recognized International Market Experts in Finance

Benchmarks Update

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Economic Issues

• Replacement of IBORs by RFRs can give rise to “value transfer” in which one party to a transaction is advantaged economically to the disadvantage of another party

• Term Structure
  ➢ 3 month LIBOR and 6 month LIBOR are term rates whereas RFRs are overnight rates
  ➢ Derivatives solution: determine/compound daily, calculate in arrears
  ➢ Does this work in other markets (e.g., loan market)?

• Spread
  ➢ LIBOR is a rate that incorporates bank credit risk
  ➢ RFRs are “risk free” rates
  ➢ To make RFRs “economically equivalent” to LIBOR, a spread needs to be added to the RFR (e.g., 3 month USD LIBOR = SOFR + 0.25%)
  ➢ A spread determined by reference to an historical average will depend on the historical period from which the spread is determined

• Bank Funding Costs
  ➢ With RFR+fixed adjustment spread, lenders may lose the ability to pass along higher funding costs to borrowers
USD LIBOR Swap Curve and SOFR Swap Curve as of January 14, 2020

Source: Bloomberg
USD LIBOR Swap Curve and SOFR Swap Rate Spreads as of January 14, 2020

Source: Bloomberg
Potential for Disputes

• Triggers – has one occurred?

• Fallbacks – are they economically equivalent?

• Continuity of contract if no fallback or if fallback is nonsensical

• Disputes regarding spreads and appropriate compensation payments, if any

• Can transition be “gamed” or manipulated?