

Transitioning LIBOR

LIBOR- London Interbank Offered Rate

The LIBOR (London Interbank Offered Rate), is the world's most widely used benchmark for short-term rates. However, its era of influence is slated to end by 2022. Most investors and borrowers have a vague sense of LIBOR since decades. Its influence as a barometer is even more tied to it. Regulators now want to retire the LIBOR for several reasons with a full phase out by early 2022.

SOFR-Secured Overnight Funding Rate

All Dollar denominated loans, derivatives and other assets will then be referenced to a new rate- The Secure Overnight Funding rate [SOFR]. The SOFR is based on transactions in the Treasury repurchase (REPO) market where investors offer banks overnight loans backed by their loans. It is seen as more preferable to the LIBOR because SOFR is based on transaction data from the Treasury Repo Market where there is extensive trading daily. In short, it uses a median of the daily traded rates.

Why replace the LIBOR?

Despite the complex growth in size of Global Markets, the Methodology of LIBOR calculation has remained unchanged: Daily, a designated group of large banks, report their funding rates to the Intercontinental Exchange Benchmark Administration (IBA). These figures are then averaged, adjusted, then released ... quite biased and thus outdated. However, the biggest concern is the significant decline in the sampling size since 2008 Financial Crisis.

As a result, the U.S Federal Reserved Commission recommended to replace the USD LIBOR in 2014 and the FED started Publishing SOFR in 2018.

Anything to fear about?

Remember Y2K? - The time when the world thought computers would shut down as 1999 turned to 2000. The end of LIBOR can be referred to that. However, the transition is meant to be gradual and measured.

The move could pose challenges for how lenders communicate rate changes to borrowers. Since SOFR is an overnight rate, lenders will estimate interest rates for consumers using a prior compounding period. Meanwhile, newly issued securitized products already have fallback clauses outlining how rates should be handled during the transition from LIBOR to SOFR.

Some important indicators

Other countries, have sought their own alternative rates while SOFR is becoming the benchmark rate to US denominated assets.

Country	LIBOR Rate	New Benchmarks
U.S.A	USD LIBOR	SOFR
UK	GBP LIBOR	SONIA
Europe	EURIBOR	ESTER
Australia	BBSW	RBA Cash rate(AONIA)
Japan	JPY LIBOR, Euroyen TIBOR	TONA
Hong Kong	HIBOR	HONIA

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