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The countdown to the end of LIBOR

Elizabeth Armitage, Goldman Sachs

Nelly Terekhova, Legal and General Investment Management

Thursday 21 November 2019

Key date
1986

What is LIBOR & why is it important?

How does it work?

What's the problem with LIBOR?

So what is the solution?



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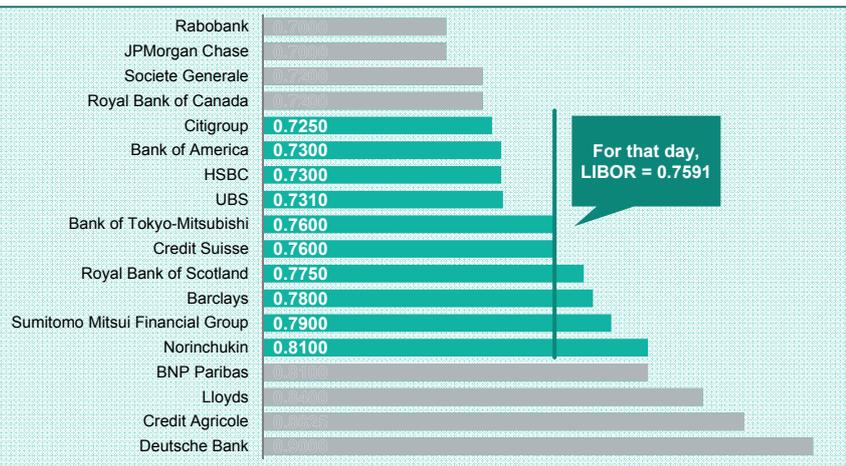
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What is LIBOR & why is it important?



¹ Source: 2014 ISDA

How does it work?



What's the problem with LIBOR?



Relevance

Limitations in the relevance of LIBOR as a benchmark rate



Sustainability & Stability

Lack of active and liquid underlying market:

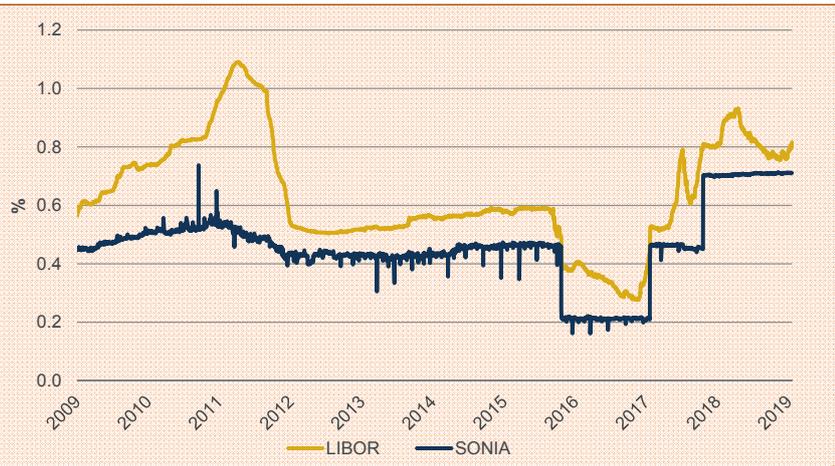
- Banks reluctant to lend unsecured overnight
- Element of bank credit risk/volatile



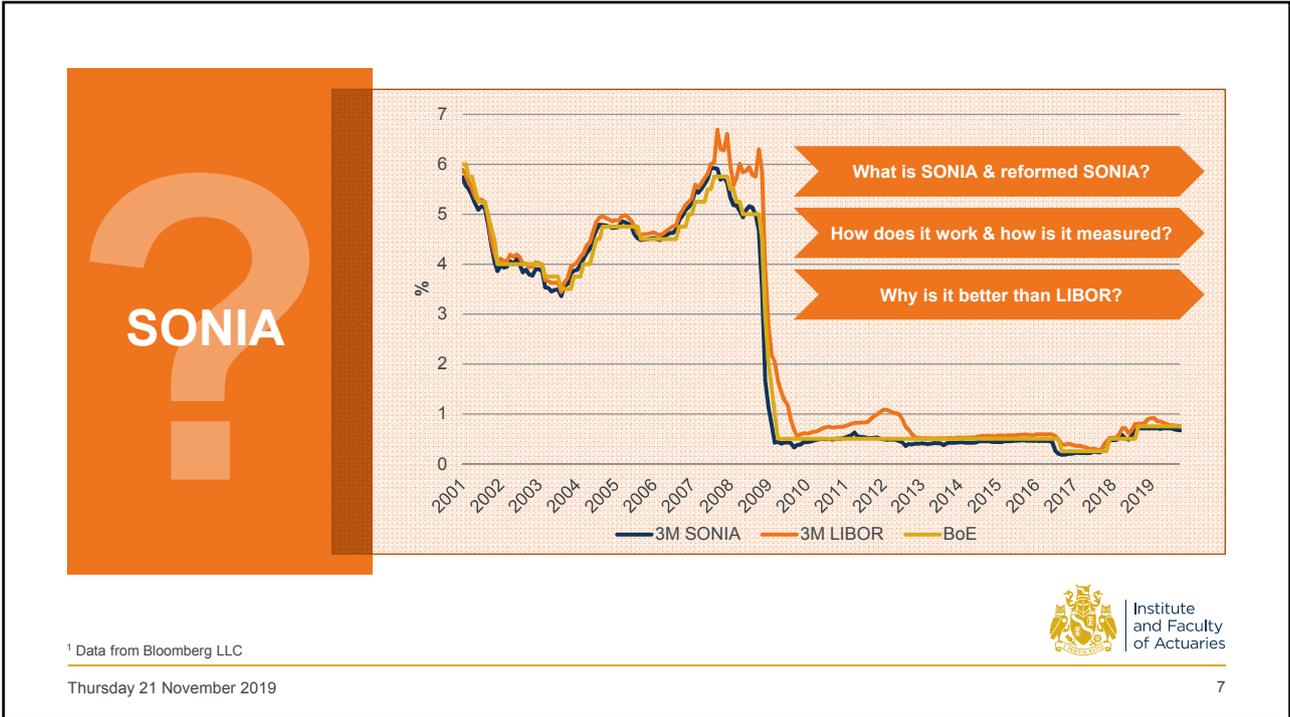
LIBOR Manipulation

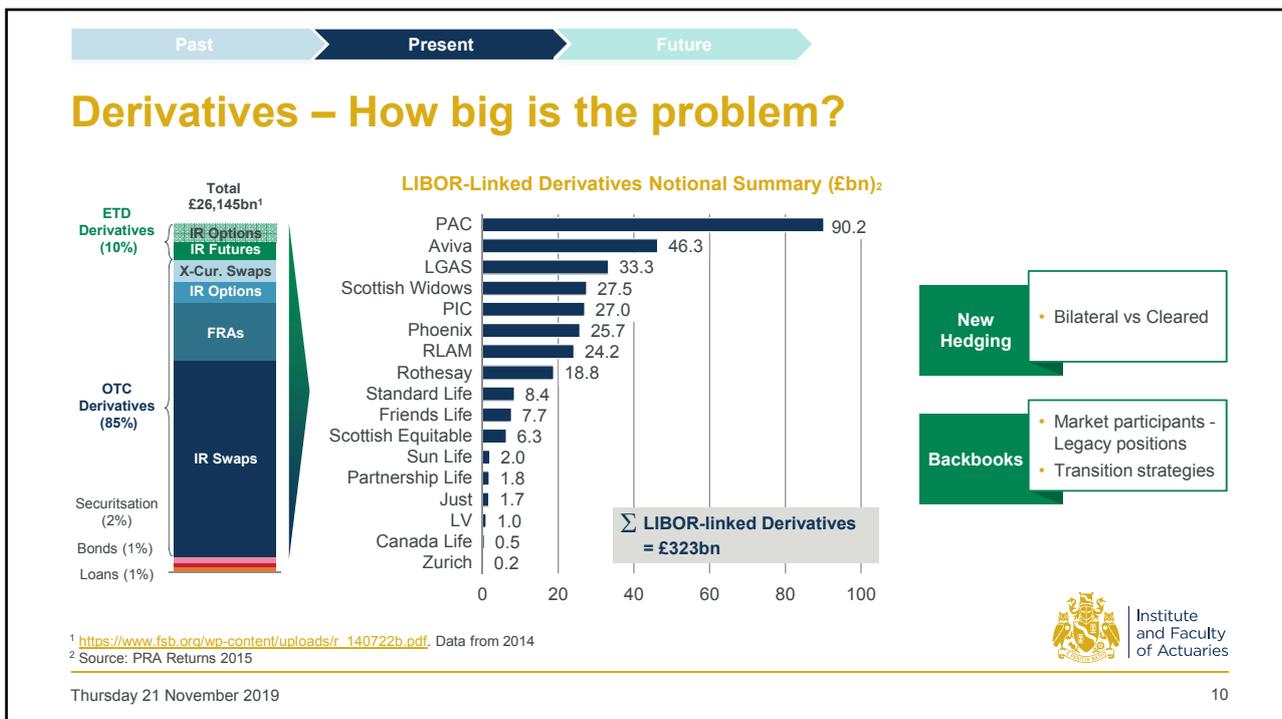
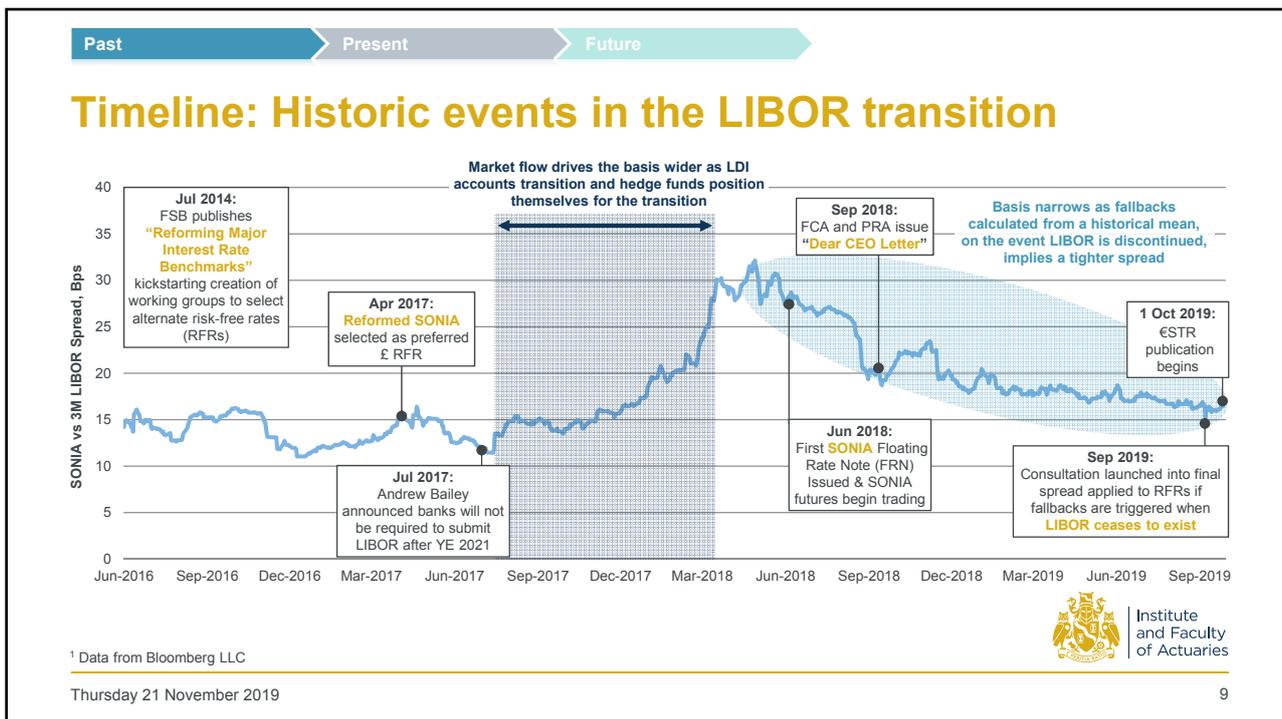
- LIBOR manipulation in the 2008 financial crisis
- 2012 LIBOR scandal.

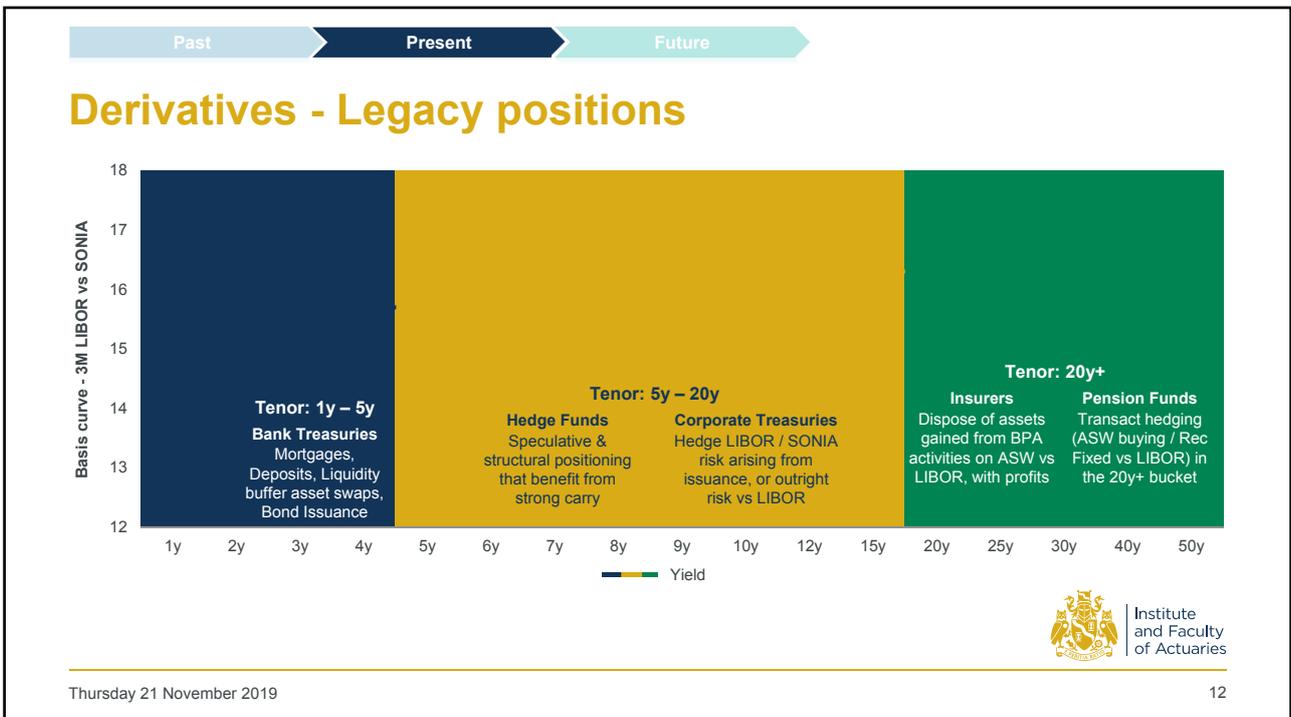
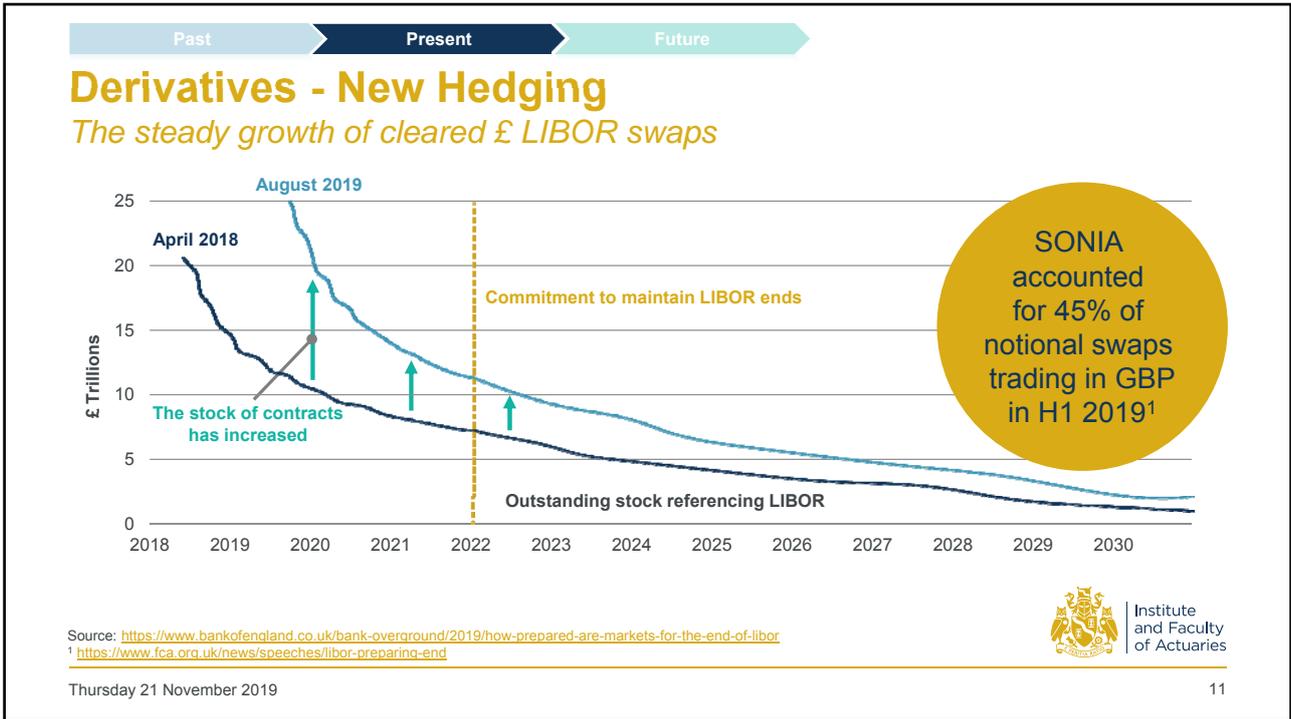
So what is the solution?



¹ Data from Bloomberg LLC







Past Present Future

Derivatives - Legacy positions

- LIBOR**
 - Rely on fallbacks
 - Diminishing liquidity
 - No transaction costs
 - LIBOR liabilities (regulatory) – No need for extra capital
- SONIA**
 - No hit at a future time
 - Increasing liquidity
 - LIBOR liabilities (regulatory) – Have to hold extra capital for basis risk
- SONIA and LIBOR**
 - Some backbook in SONIA
 - All new trades in SONIA
 - Good liquidity
 - Some hit at a future time
 - LIBOR liabilities (regulatory) – Have to hold some capital

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Thursday 21 November 2019 13

Past Present Future

Derivatives - Fallback Analysis

Fallback LIBOR = SONIA + spread

Consultation on the final parameters applicable to RFRs if derivative fallbacks are triggered

ISDA narrowed the final spread adjustment approach to: **5Y median vs 10Y trimmed mean**

Decision was announced 15th November 2019, ISDA expects to implement a historical median spread adjustment over a five-year lookback period

Spread adjustment will **likely be the same across IBOR rates**

- Minimize risks of distortion in cross-currency hedging
- Avoid creating unnecessary dislocations in the basis market
- Limit regulatory arbitrage across jurisdictions.

6M LIBOR vs SONIA - Bps

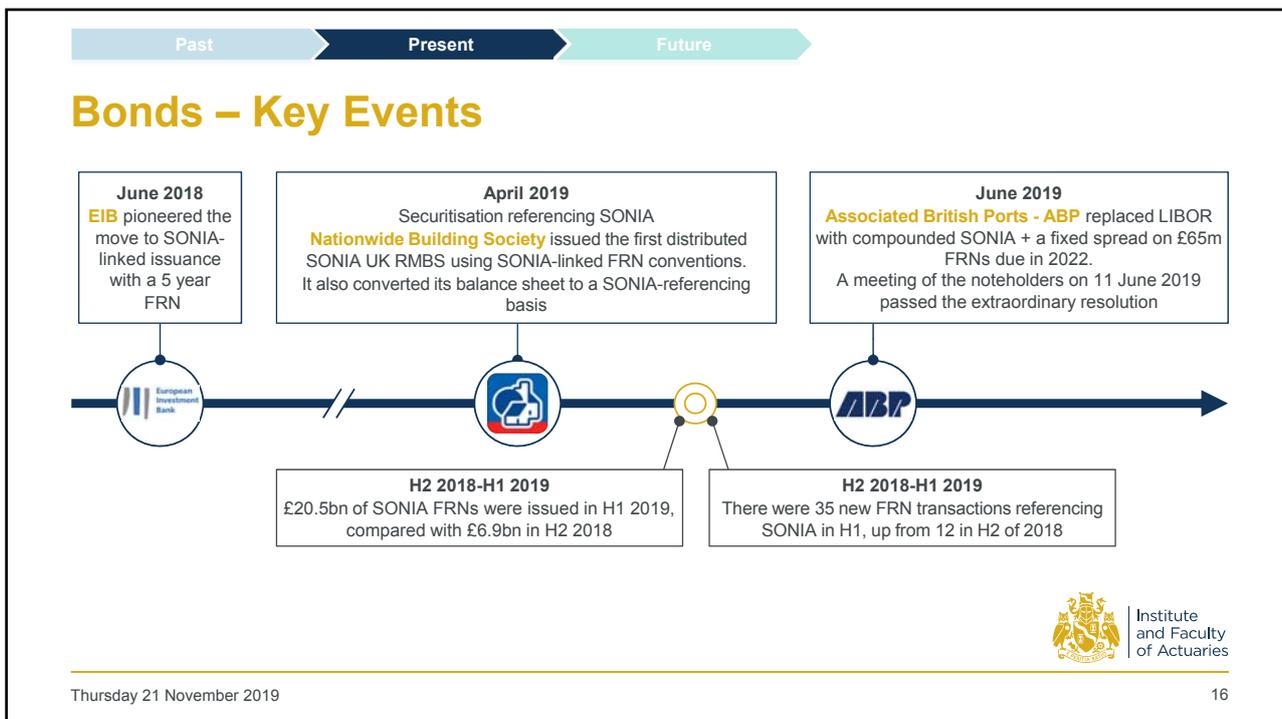
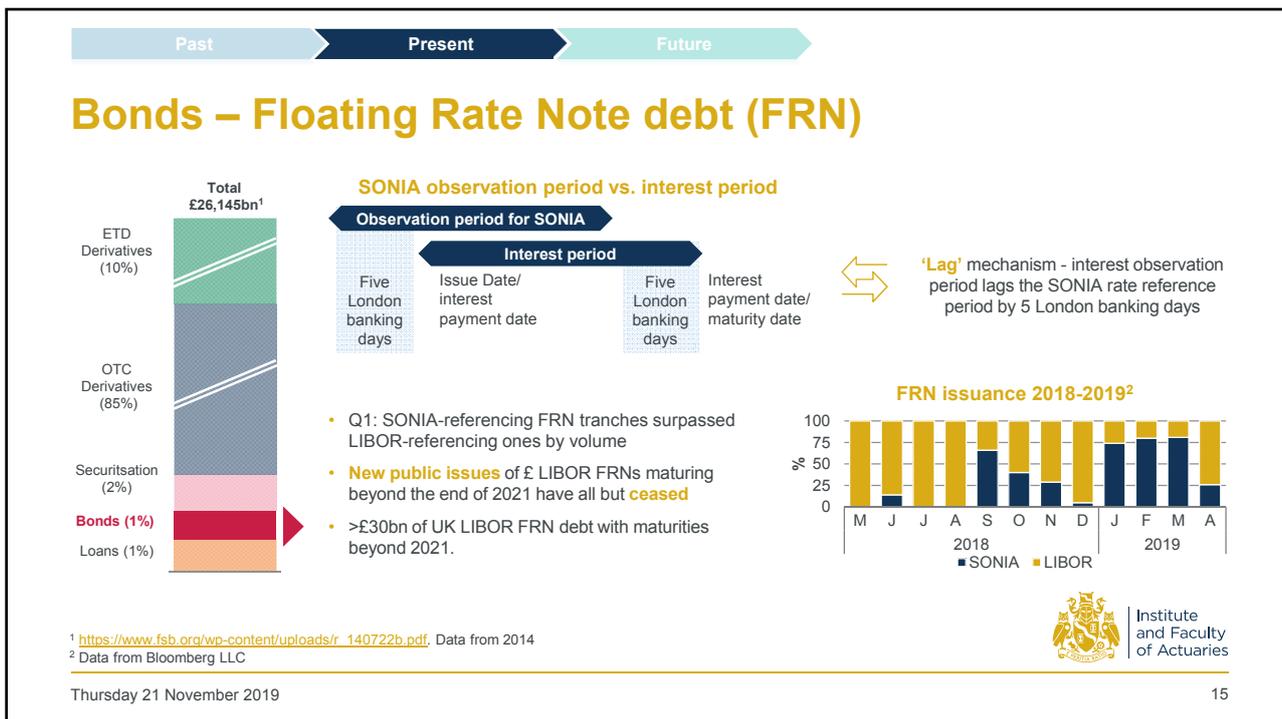
0y 5y 10y 15y 20y 25y 30y 35y 40y 45y 50y

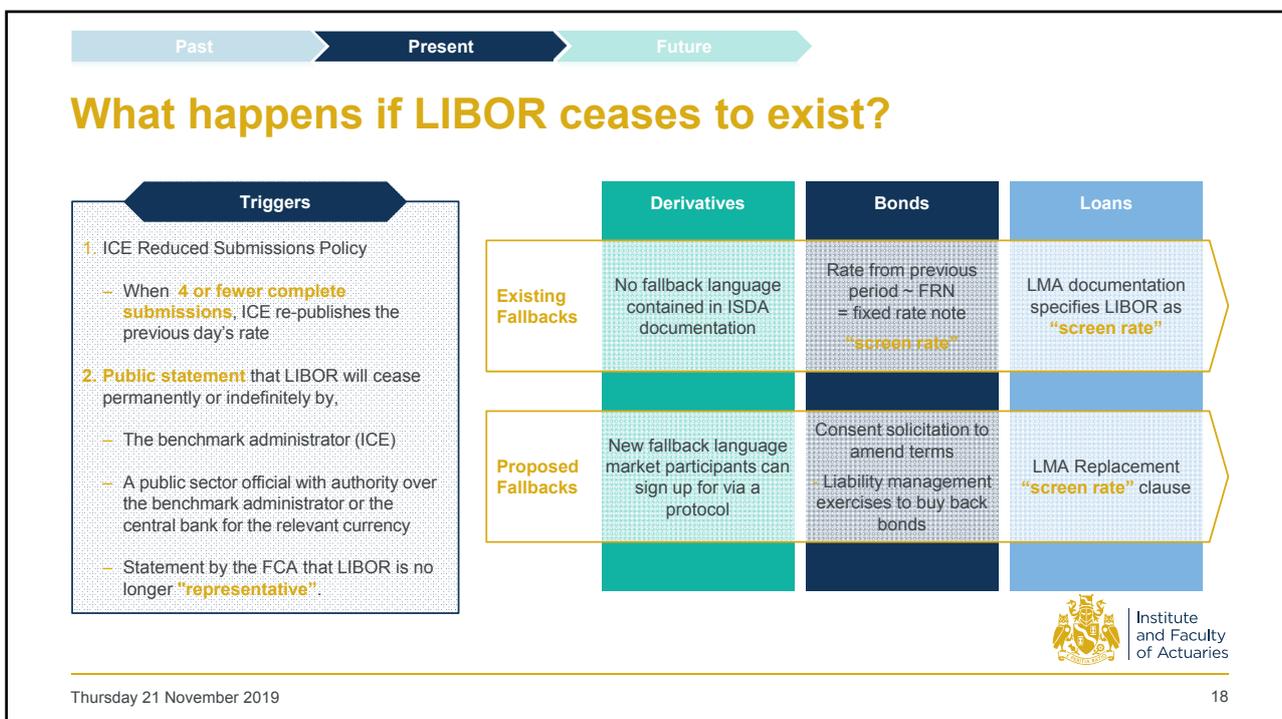
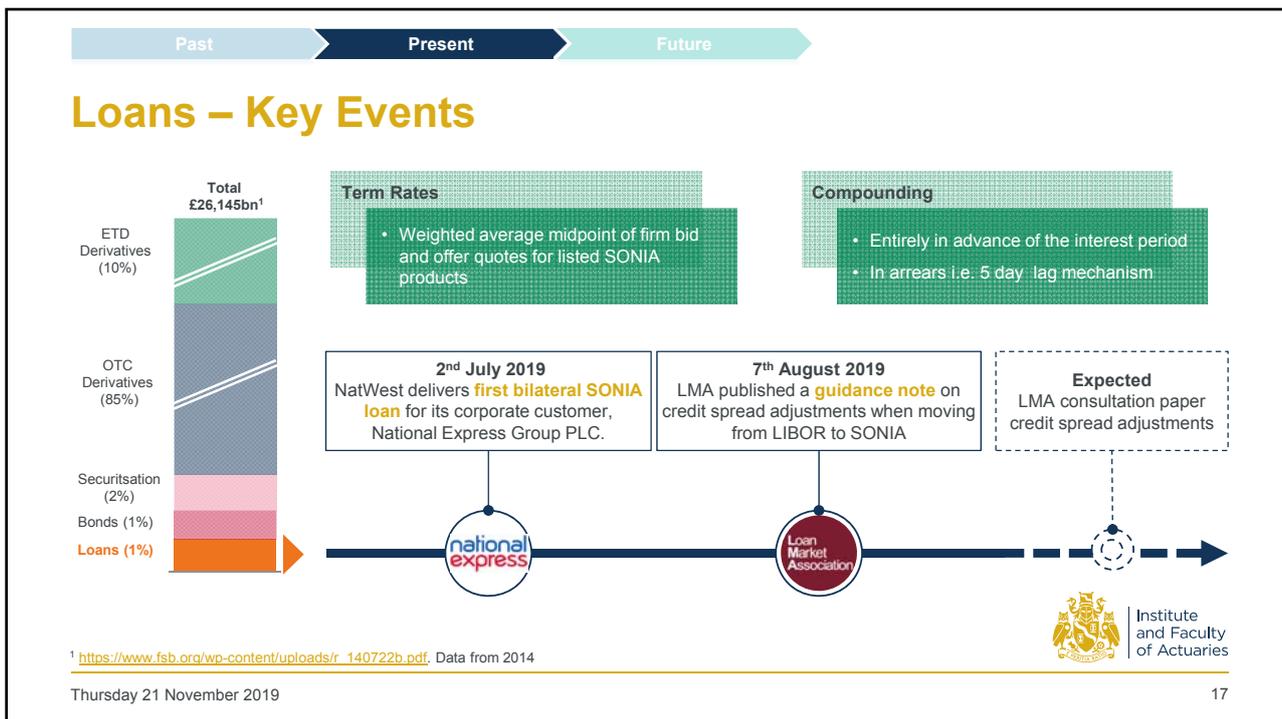
— 2016 — 2017 — 2018 — Nov-2019

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¹ Data from Bloomberg LLC

Thursday 21 November 2019 14





Past
Present
Future

What about the rest of the world? – USD

USD

- SOFR (Secured Overnight Financing Rate) - measure of the cost of borrowing cash overnight collateralized by **US Treasury securities**
- CME/LCH (clearing houses) started clearing SOFR swaps in 2018
- Trading in SOFR swaps and futures has increased but volumes are **still very modest**
- Issuance \$265bn SOFR vs \$811bn LIBOR in 2019.

Asset	Estimate of Liquidity ¹	
	SOFR	SONIA
Swaps		
Futures & Forwards		
Bonds		
Loans		

■ Sufficient liquidity for all activity to take place in RFR market
□ No liquidity in RFR markets

— SOFR²

¹ <https://www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2019/jun/Time-To-Switch-Rates-LIBOR-Transition-FINAL.pdf>
² Data from Bloomberg LLC

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Thursday 21 November 2019 19

Past
Present
Future

What about the rest of the world? – EUR

EUR

- €STR (Euro Short-Term Rate) published for the first time on **2 Oct 2019**
- EIB also printed the market's **first €STR bond**
- Reflects wholesale € unsecured overnight borrowing costs of € area banks, based **entirely on actual individual transactions**.

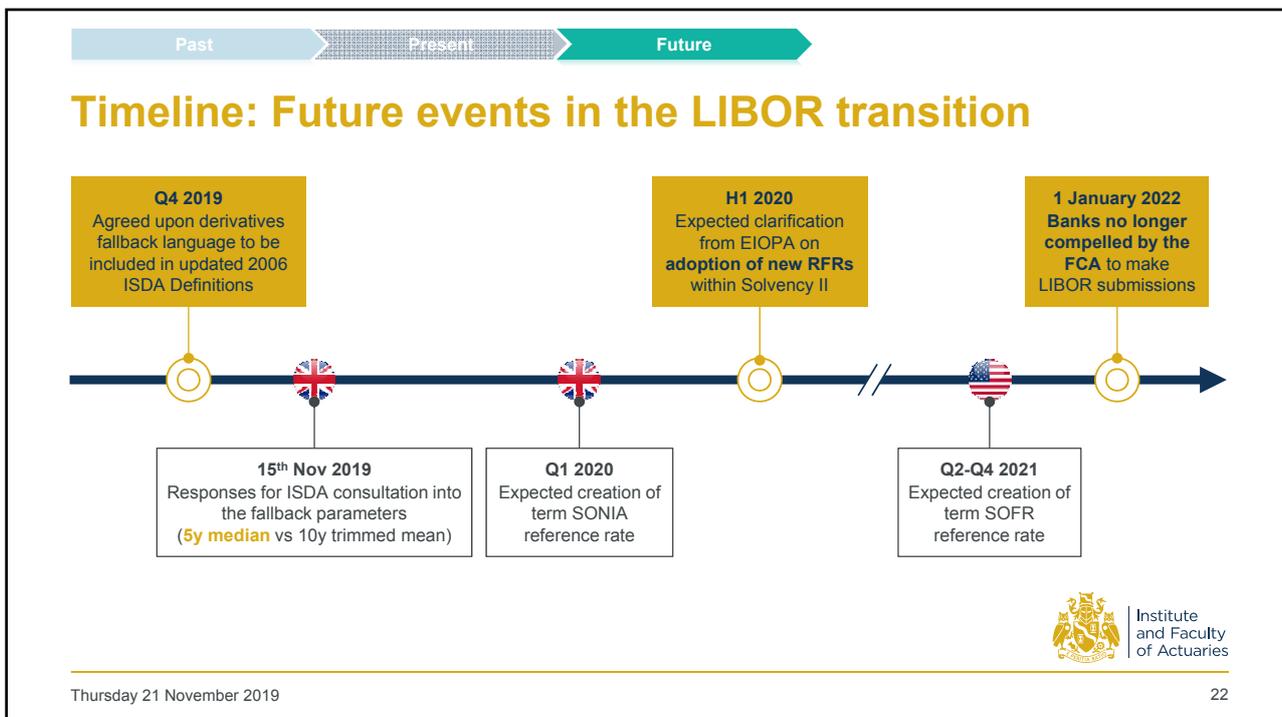
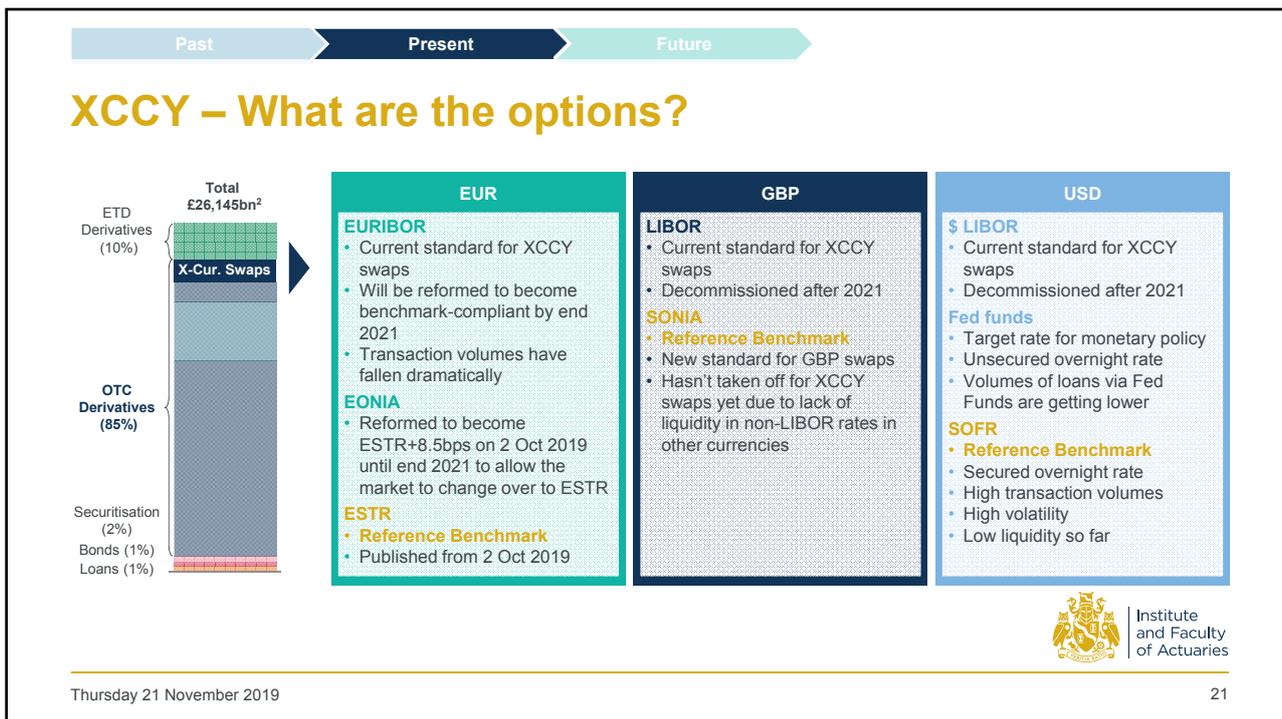
Bond Issuance vs OIS – SONIA, EONIA (EUR), SOFR/FF

■ ≤ 2 years ■ 2-5 years ■ 5+ years

Source: <https://www.clarusft.com/ester-what-you-need-to-know/>

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Thursday 21 November 2019 20





The countdown to the end of LIBOR

“Some say only two things in life are guaranteed: death and taxes.
But I say there are actually three: death, taxes and the end of LIBOR”

*John Williams,
New York Fed President*

Will the market make the deadline?



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Thursday 21 November 2019 23