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The countdown to the end of LIBOR

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Wednesday 11 March 2020

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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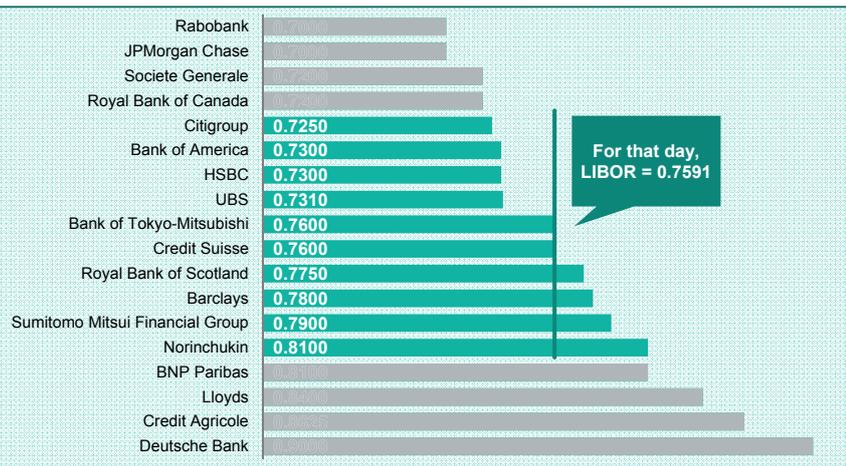
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What is LIBOR & why is it important?



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:

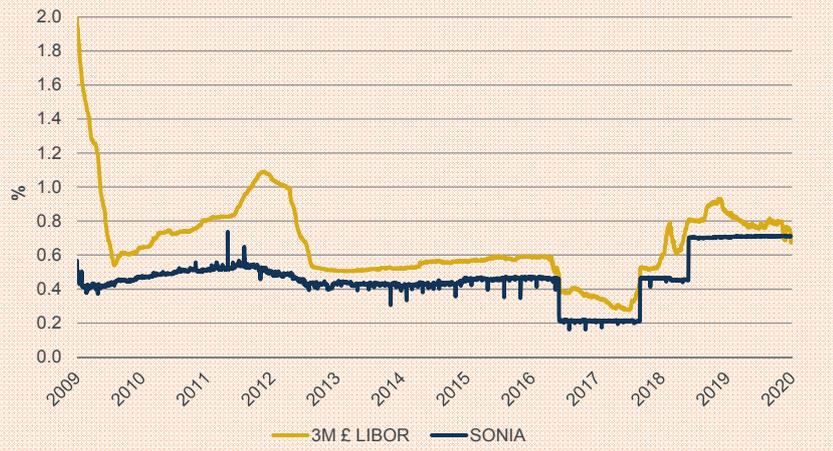
- Banks reluctant to lend unsecured overnight
- Element of bank credit risk/volatile



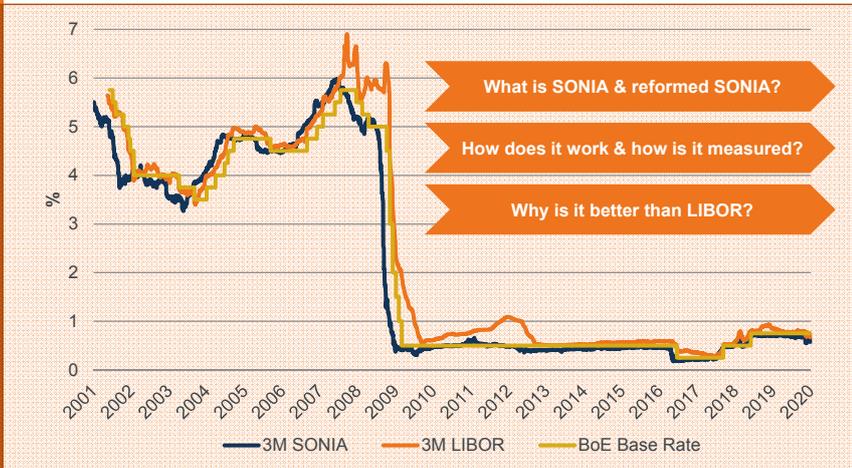
LIBOR Manipulation

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

So what is the solution?



¹ Data from Bloomberg LLC

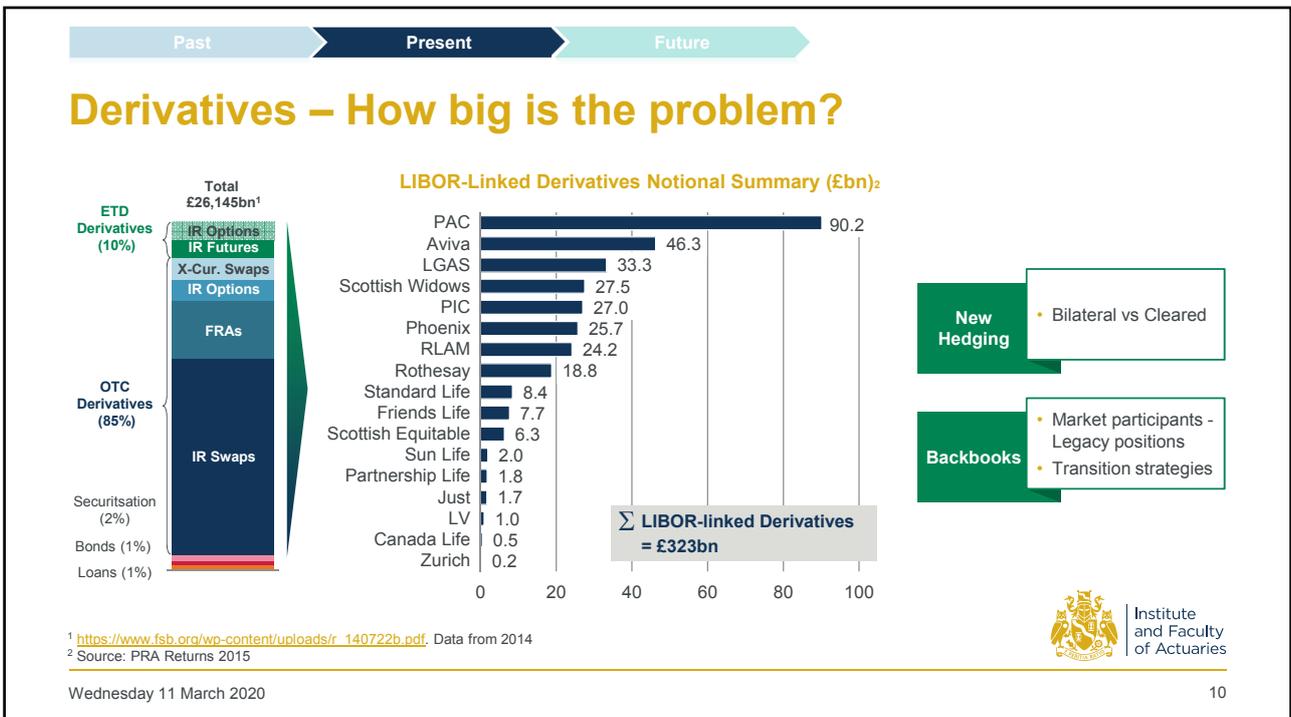
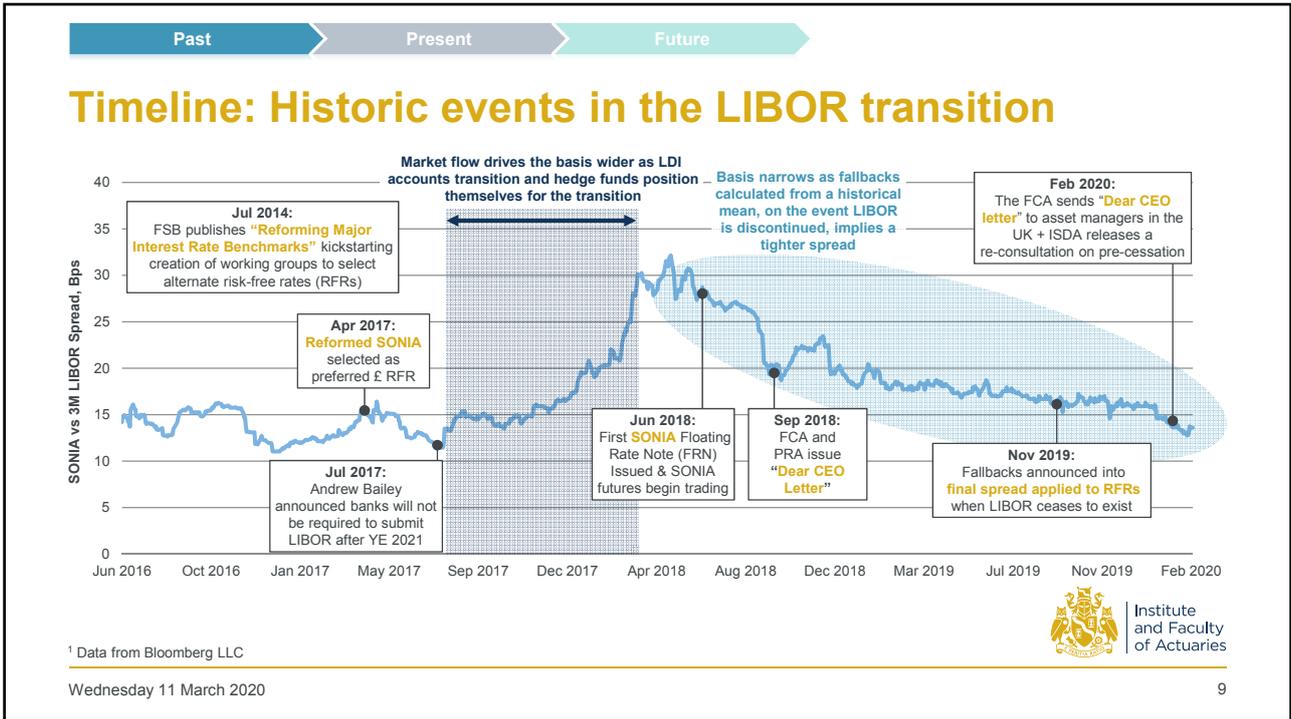


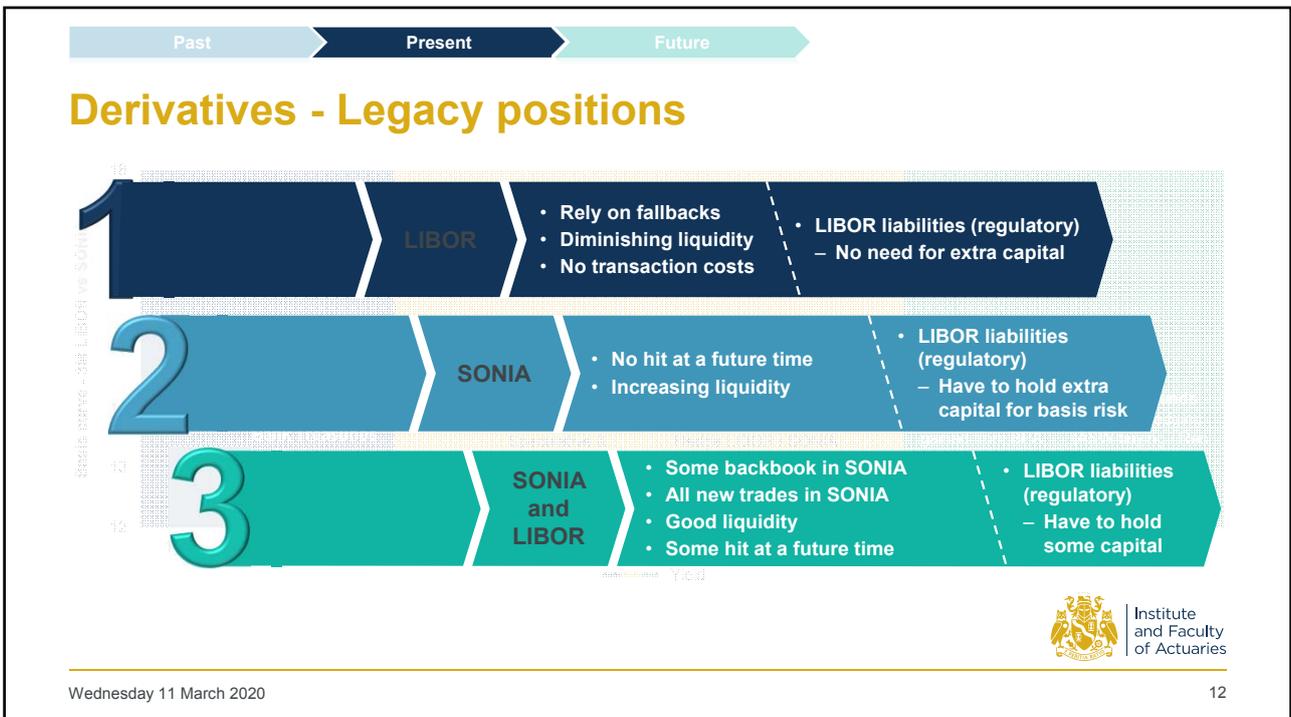
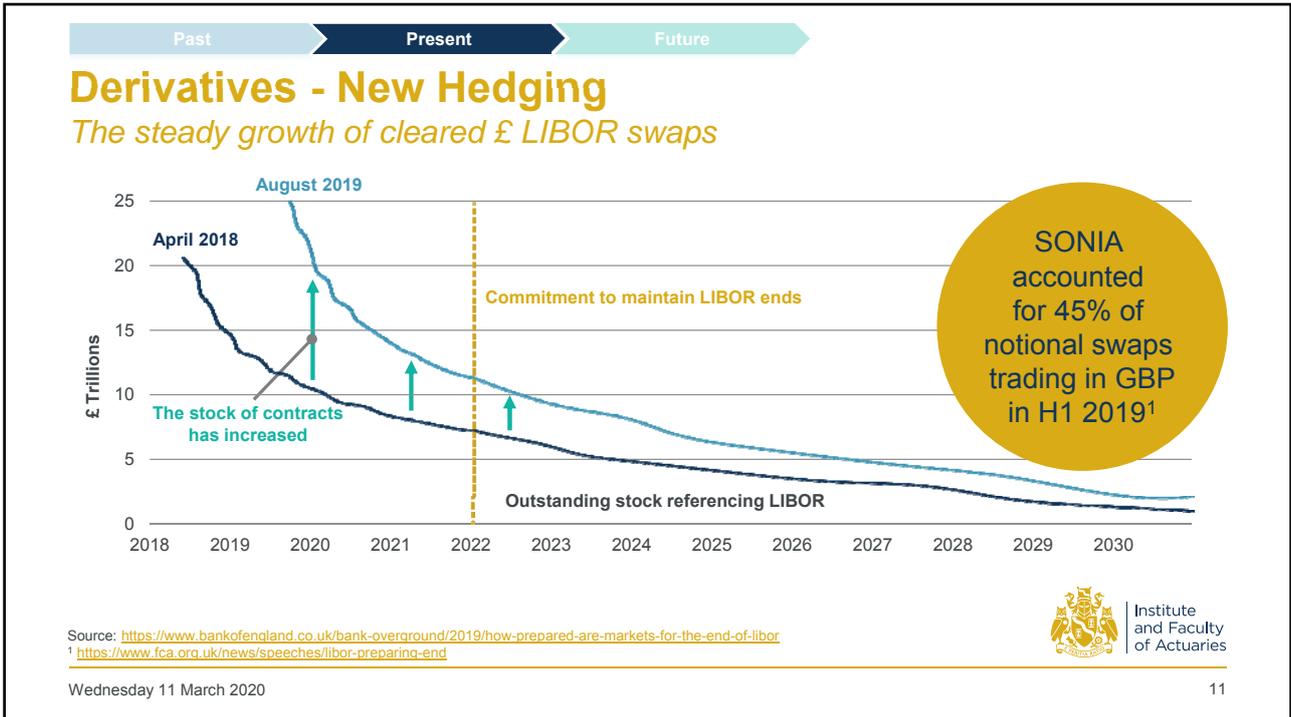
¹ Data from Bloomberg LLC



The countdown to the end of LIBOR







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.

2021/2022 Implied Fallback: 17.7/17.8

¹ Data from Bloomberg LLC

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Past
Present
Future

Bonds – Floating Rate Note debt (FRN)

Total £26,145bn¹

SONIA observation period vs. interest period

Observation period for SONIA

Five London banking days

Interest period

Issue Date/
interest
payment date

Five London banking days

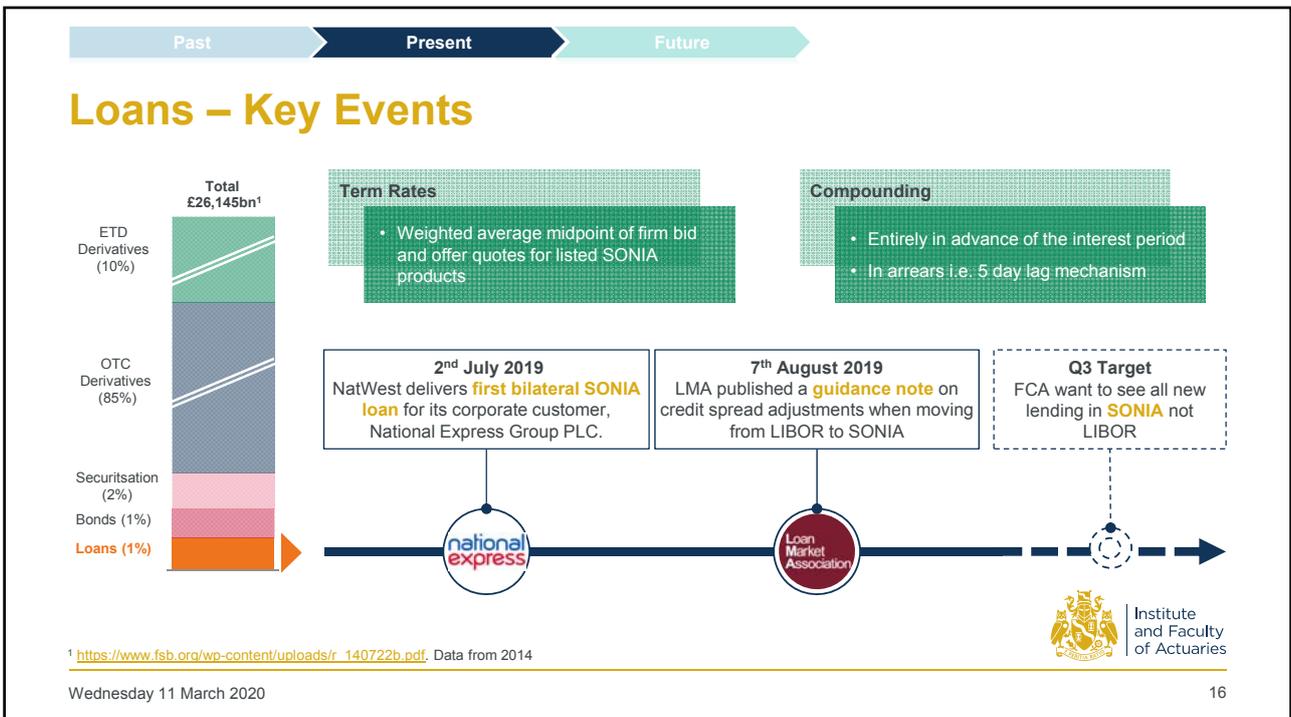
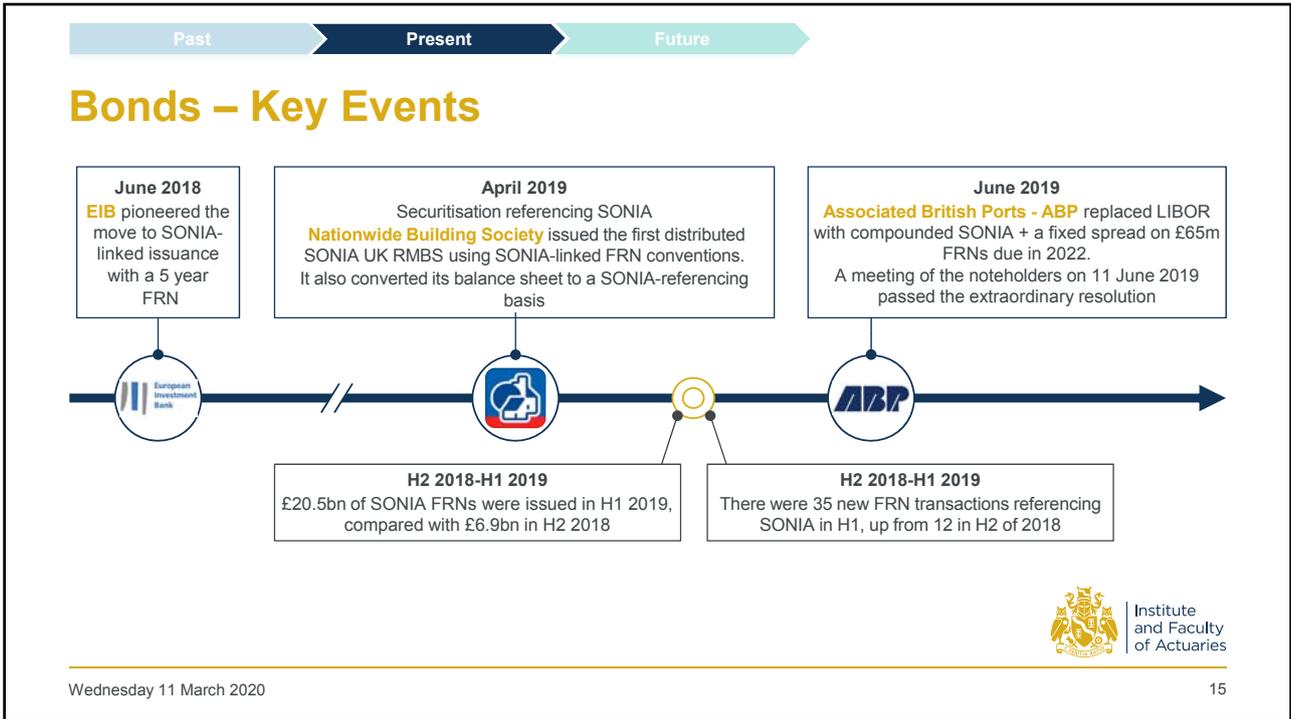
Interest
payment date/
maturity date

↔ 'Lag' mechanism - interest observation period lags the SONIA rate reference period by 5 London banking days

FRN issuance 2018-2019²

¹ https://www.fsb.org/wp-content/uploads/r_140722b.pdf, Data from 2014

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Past → Present → Future

What happens if LIBOR ceases to exist?

Triggers

1. ICE Reduced Submissions Policy
 - When **4 or fewer complete submissions**, ICE re-publishes the previous day's rate
2. **Public statement** that LIBOR will cease permanently or indefinitely by,
 - The benchmark administrator (ICE)
 - A public sector official with authority over the benchmark administrator or the central bank for the relevant currency
3. Statement by the FCA that LIBOR is no longer **"representative"**

	Derivatives	Bonds	Loans
Existing Fallbacks	No fallback language contained in ISDA documentation	Rate from previous period ~ FRN = fixed rate note "screen rate"	Lender's cost of funds
Proposed Fallbacks	New fallback language market participants can sign up for via a protocol	Consent solicitation to amend terms - Liability management exercises to buy back bonds	LMA Replacement "screen rate" clause



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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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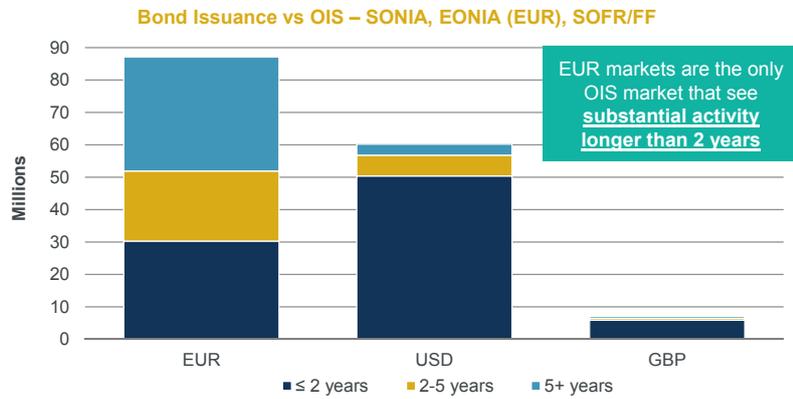
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What about the rest of the world? – EUR

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**.



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

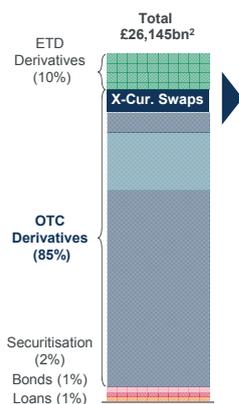


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XCCY – What are the options?



EUR

EURIBOR

- Current standard for XCCY swaps
- Will be reformed to become benchmark-compliant by end 2021
- Transaction volumes have fallen dramatically

EONIA

- Reformed to become ESTR+8.5bps on 2 Oct 2019 until end 2021 to allow the market to change over to ESTR

ESTR

- **Reference Benchmark**
- Published from 2 Oct 2019

GBP

LIBOR

- Current standard for XCCY swaps
- Decommissioned after 2021

SONIA

- **Reference Benchmark**
- New standard for GBP swaps
- Hasn't taken off for XCCY swaps yet due to lack of liquidity in non-LIBOR rates in other currencies

USD

\$ LIBOR

- Current standard for XCCY swaps
- Decommissioned after 2021

Fed funds

- Target rate for monetary policy
- Unsecured overnight rate
- Volumes of loans via Fed Funds are getting lower

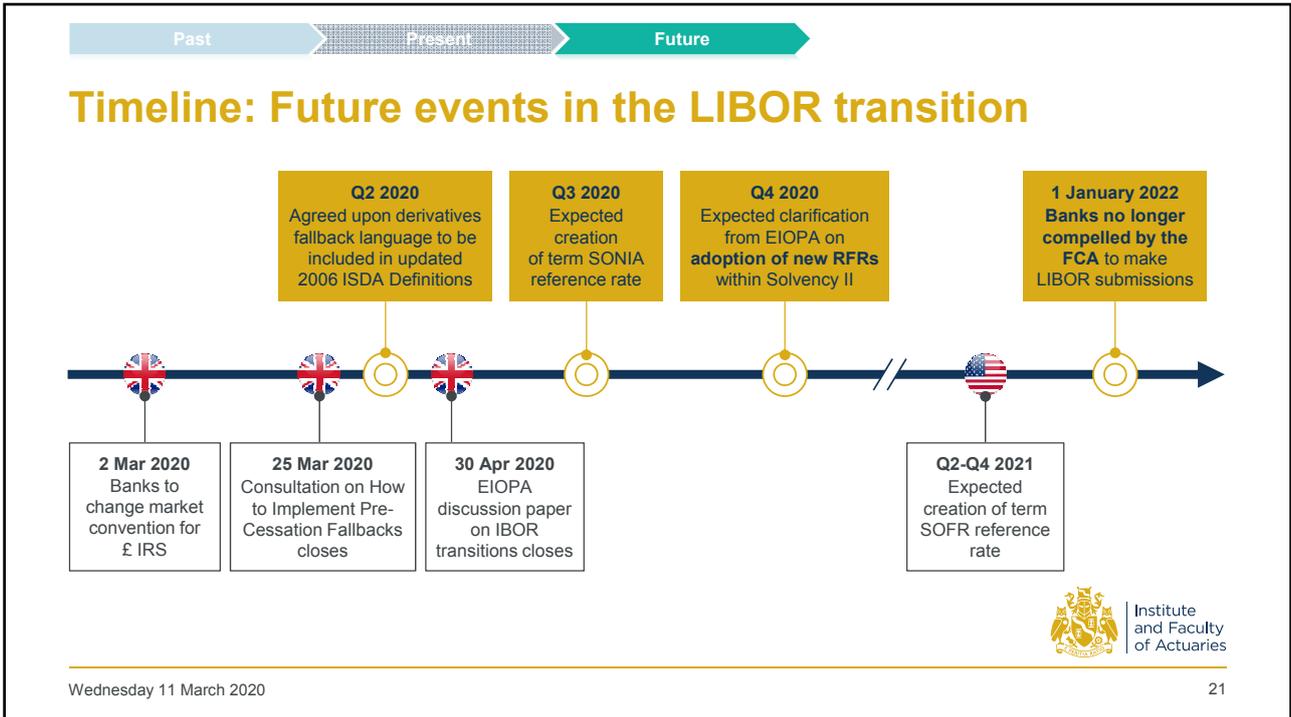
SOFR

- **Reference Benchmark**
- Secured overnight rate
- High transaction volumes
- High volatility
- Low liquidity so far



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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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