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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?

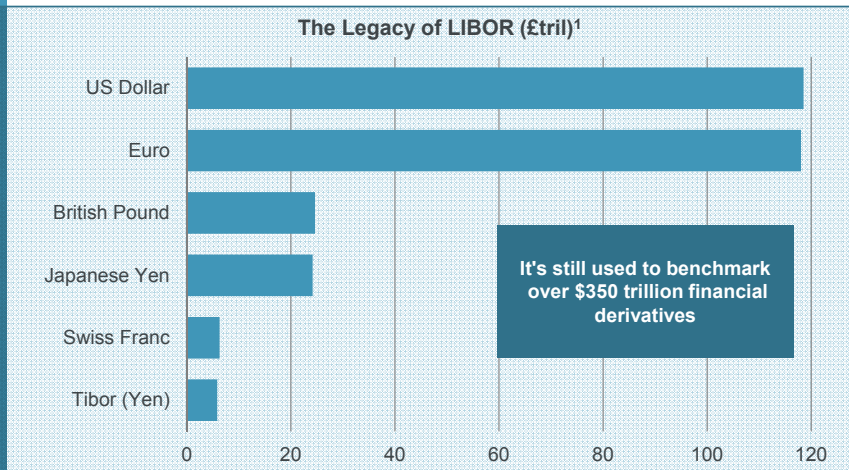


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What is LIBOR & why is it important?



¹ Source: 2014 ISDA

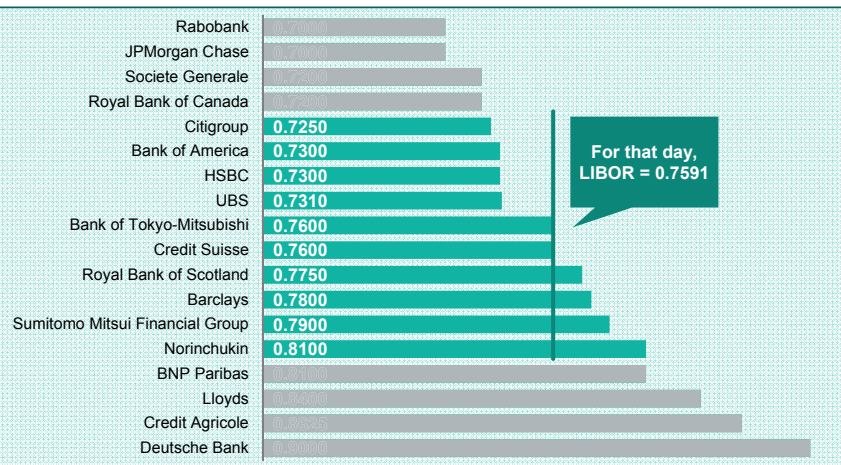


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How does it work?



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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

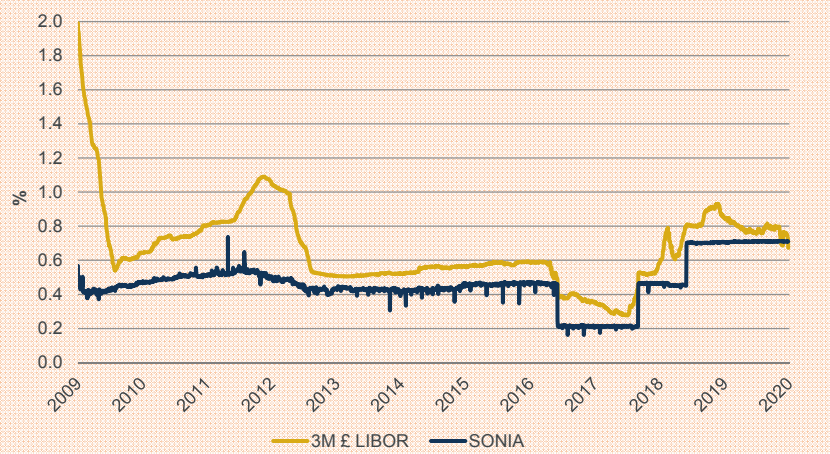


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So what is the solution?



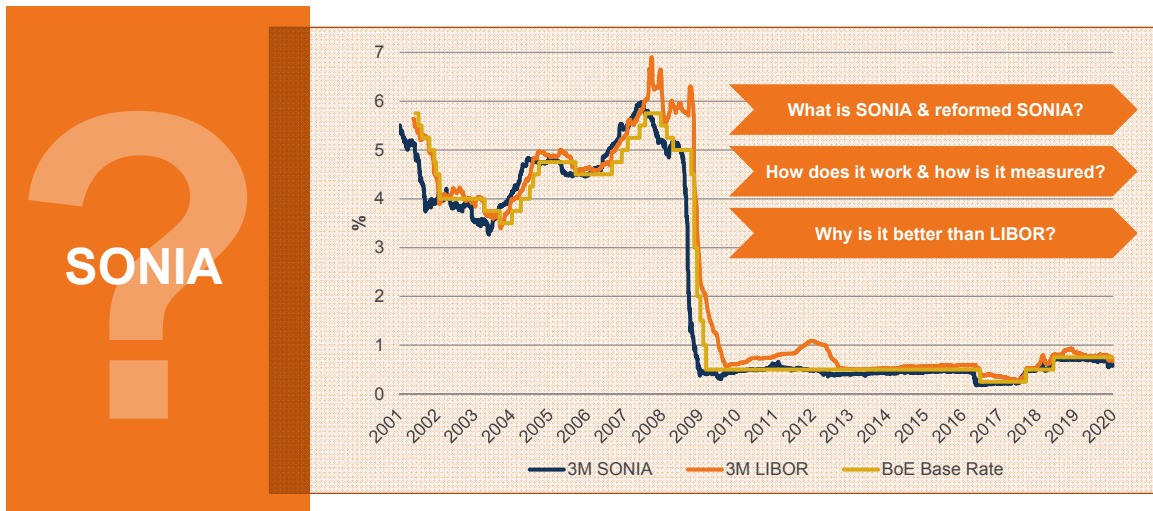
¹ Data from Bloomberg LLC



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¹ Data from Bloomberg LLC

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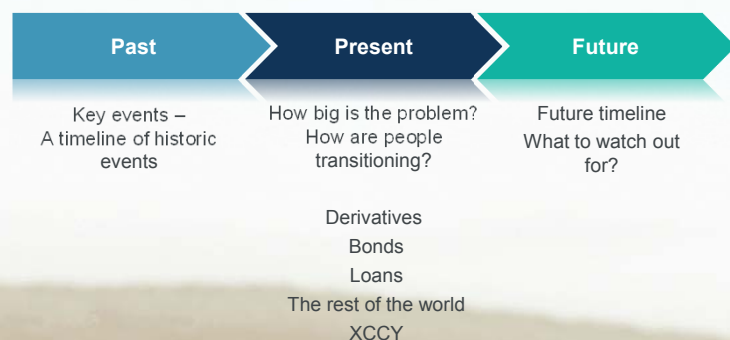


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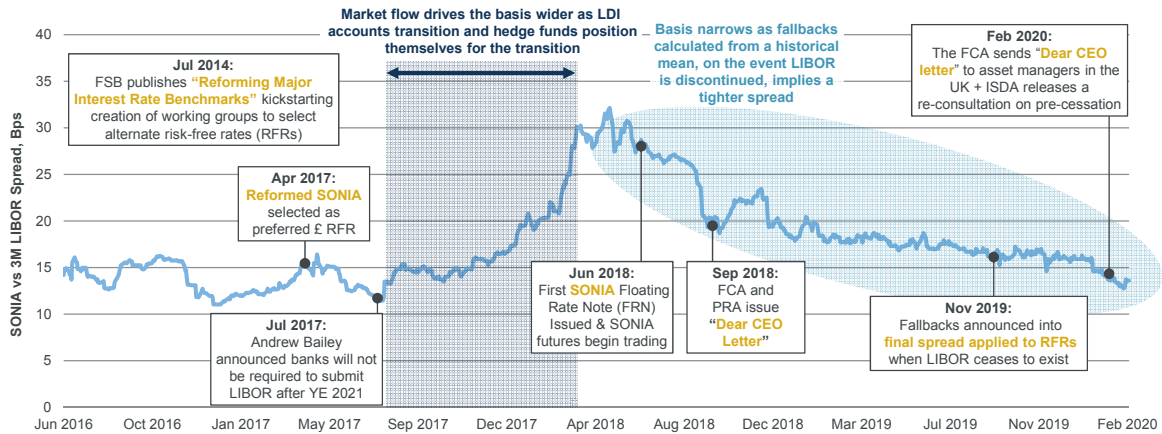
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Past Present Future

Timeline: Historic events in the LIBOR transition



¹ Data from Bloomberg LLC

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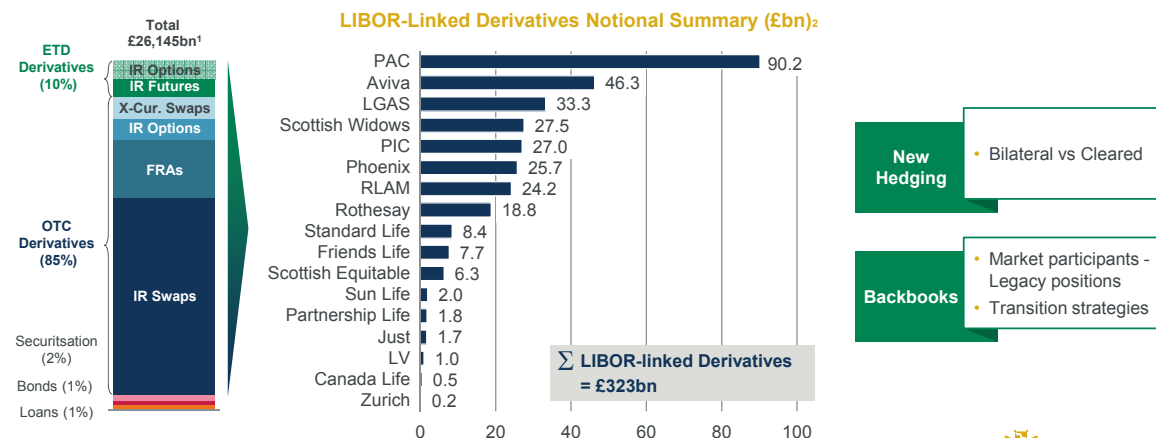


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Past Present Future

Derivatives – How big is the problem?



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

² Source: PRA Returns 2015

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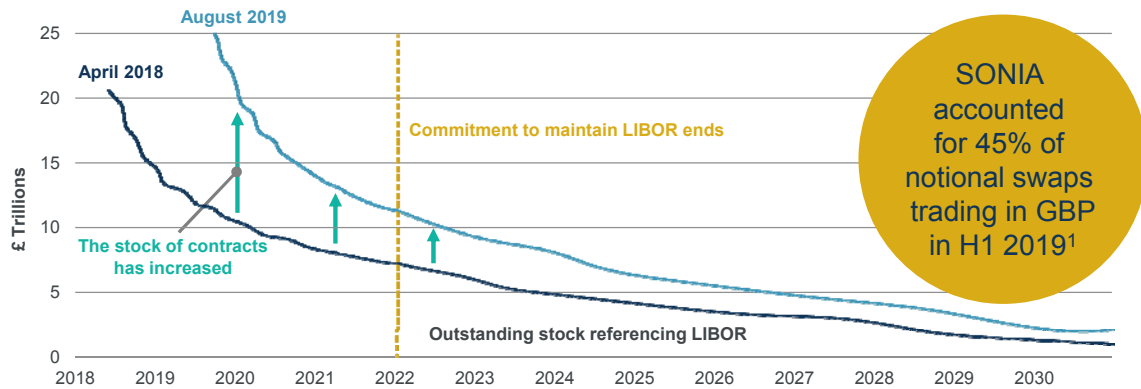
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Past Present Future

Derivatives - New Hedging

The steady growth of cleared £ LIBOR swaps



Source: <https://www.bankofengland.co.uk/bank-overground/2019/how-prepared-are-markets-for-the-end-of-libor>
¹ <https://www.fca.org.uk/news/speeches/libor-preparing-end>



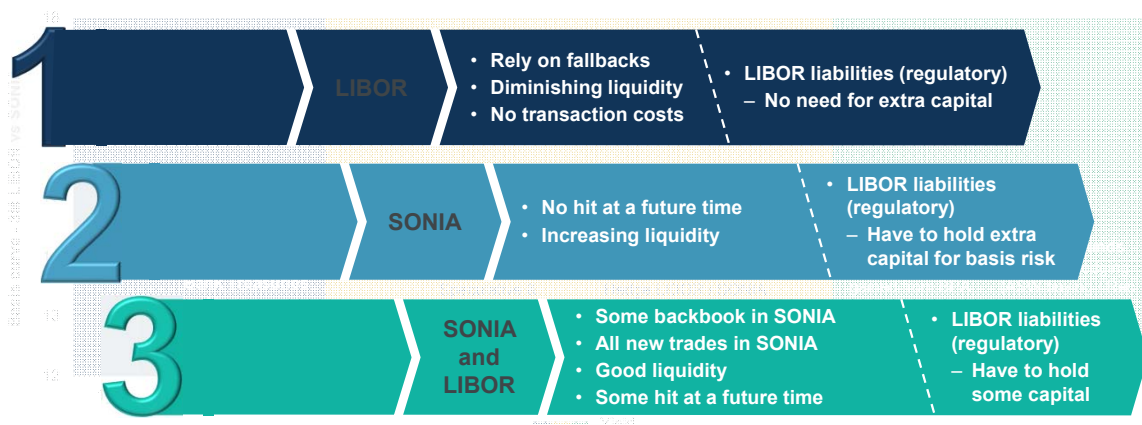
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Past Present Future

Derivatives - Legacy positions



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Past Present Future

Derivatives - Fallback Analysis

Fallback LIBOR = SONIA + spread

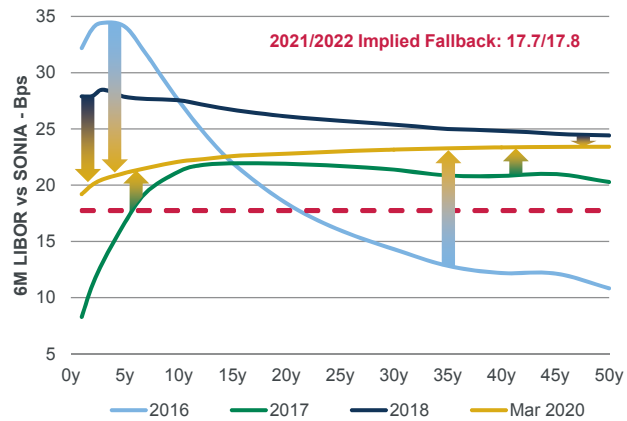
Consultation on the final parameters applicable to RFRs
if derivative fallbacks are triggered

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.



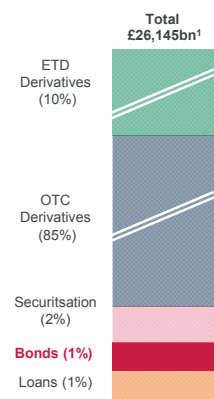
¹ Data from Bloomberg LLC

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Past Present Future

Bonds – Floating Rate Note debt (FRN)



SONIA observation period vs. interest period

Observation period for SONIA

Five
London
banking
days

Issue Date/
interest
payment date

Interest period

Five
London
banking
days

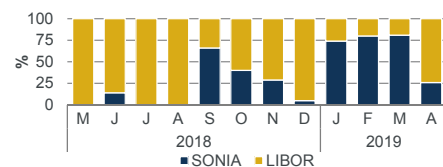
Interest
payment date/
maturity date



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

- Q1: SONIA-referencing FRN tranches surpassed LIBOR-referencing ones by volume
- New public issues of £ LIBOR FRNs maturing beyond the end of 2021 have all but **ceased**
- >£30bn of UK LIBOR FRN debt with maturities beyond 2021.

FRN issuance 2018-2019²



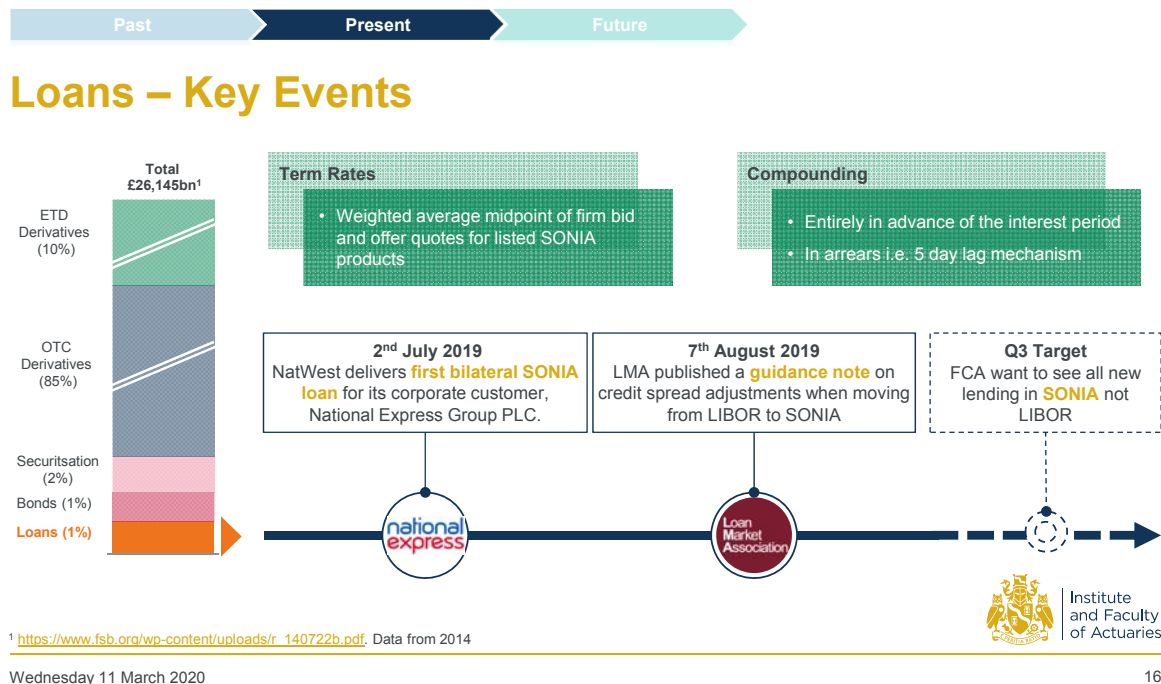
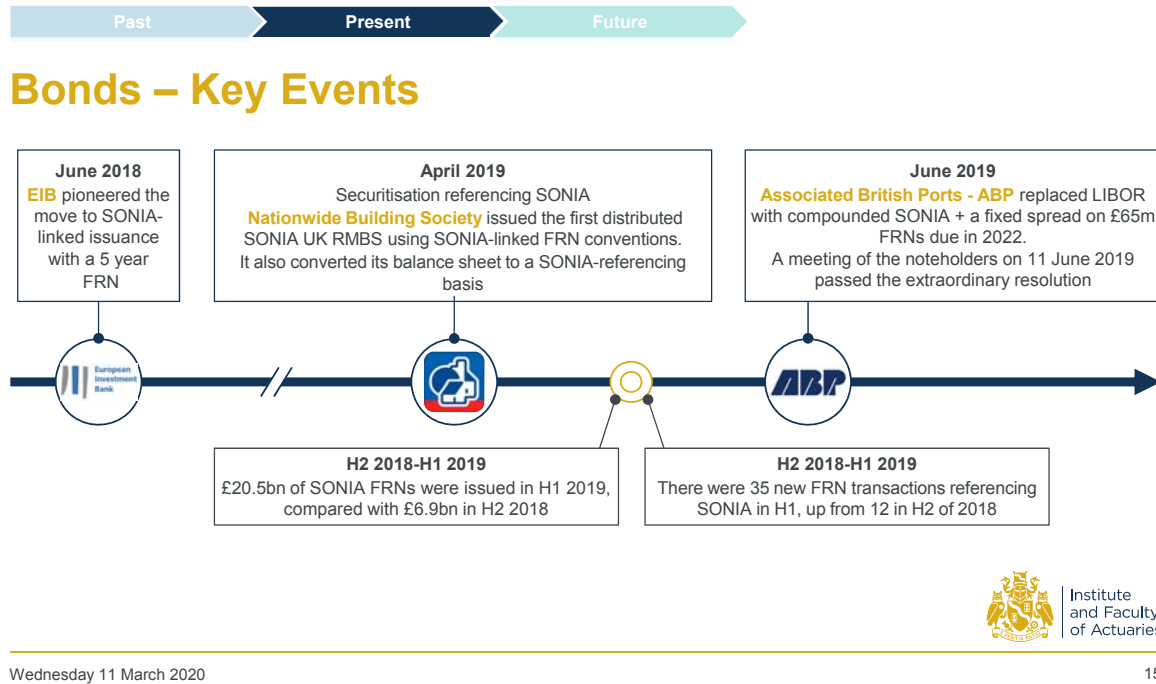
¹ https://www.fsb.org/wp-content/uploads/r_140722b.pdf, Data from 2014

² Data from Bloomberg LLC



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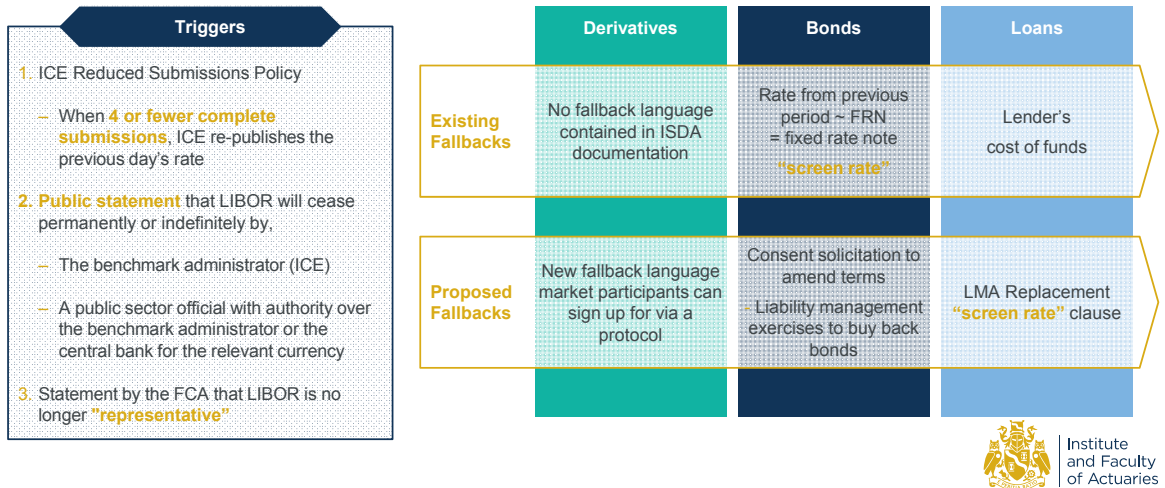
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¹ https://www.fsb.org/wp-content/uploads/r_140722b.pdf, Data from 2014

Past → Present → Future

What happens if LIBOR ceases to exist?

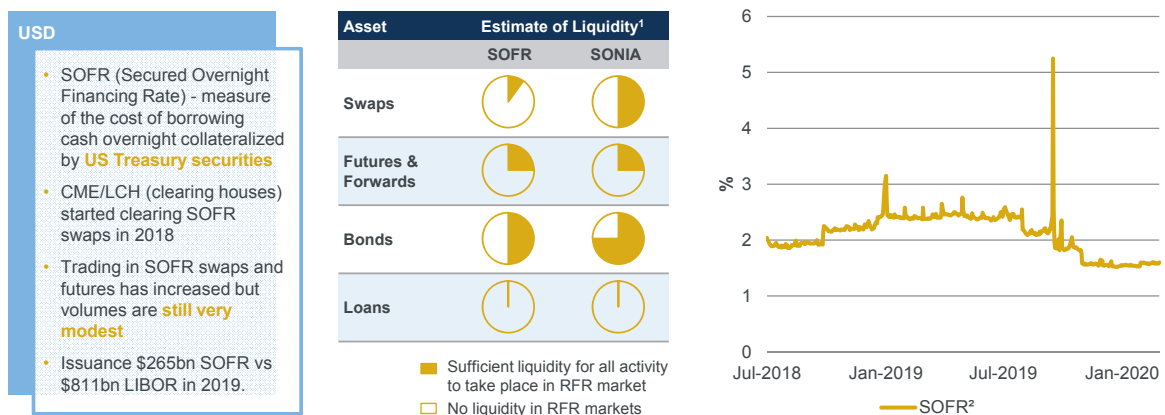


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Past → Present → Future

What about the rest of the world? – USD



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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Past

Present

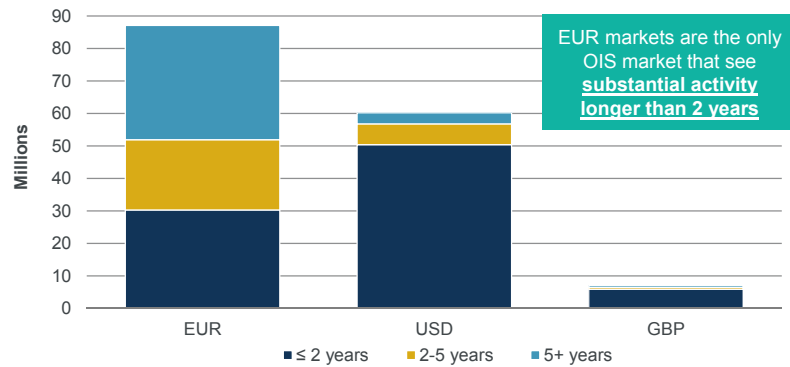
Future

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



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

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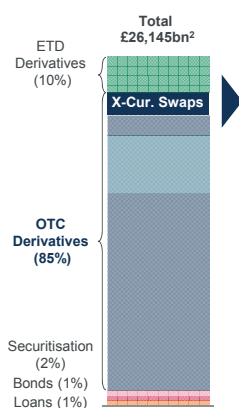
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Past

Present

Future

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

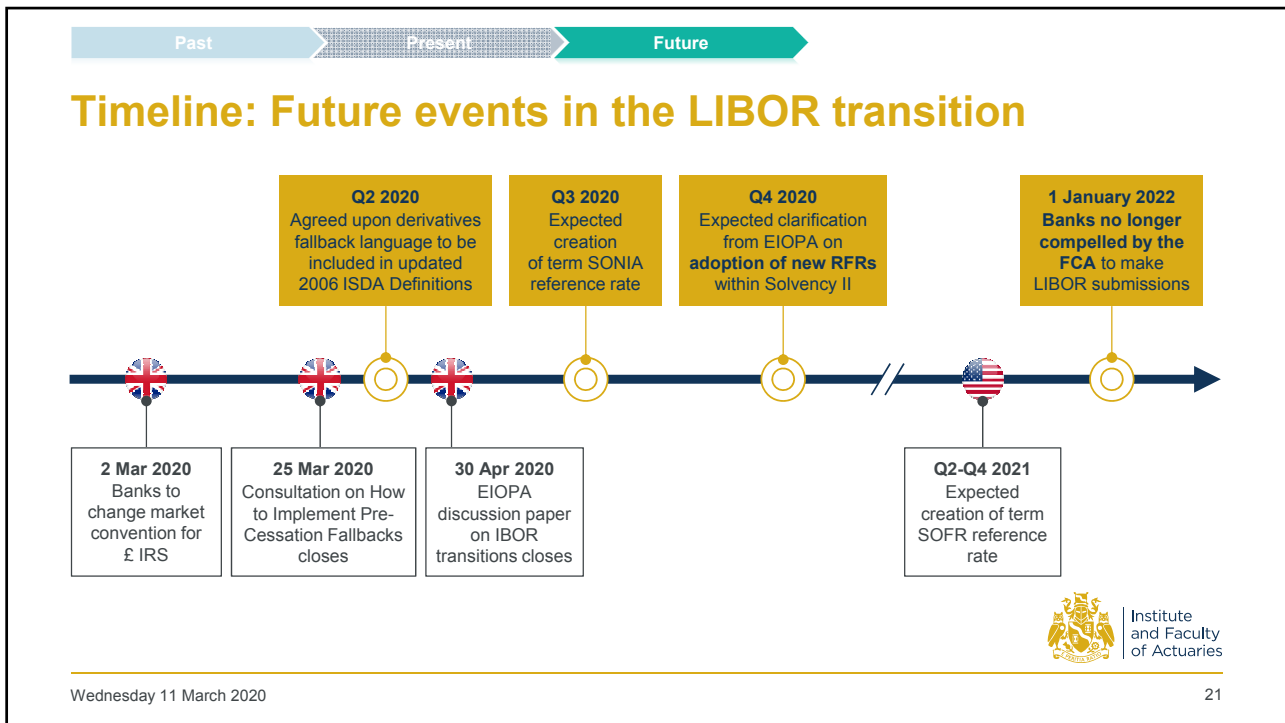
- \$ LIBOR**
 - Current standard for XCCY swaps
 - Decommissioned after 2021
- Fed funds**
 - Target rate for monetary policy
 - Unsecured overnight rate
 - Volumes of loans via Fed Funds are getting lower
- SOFR**
 - **Reference Benchmark**
 - Secured overnight rate
 - High transaction volumes
 - High 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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