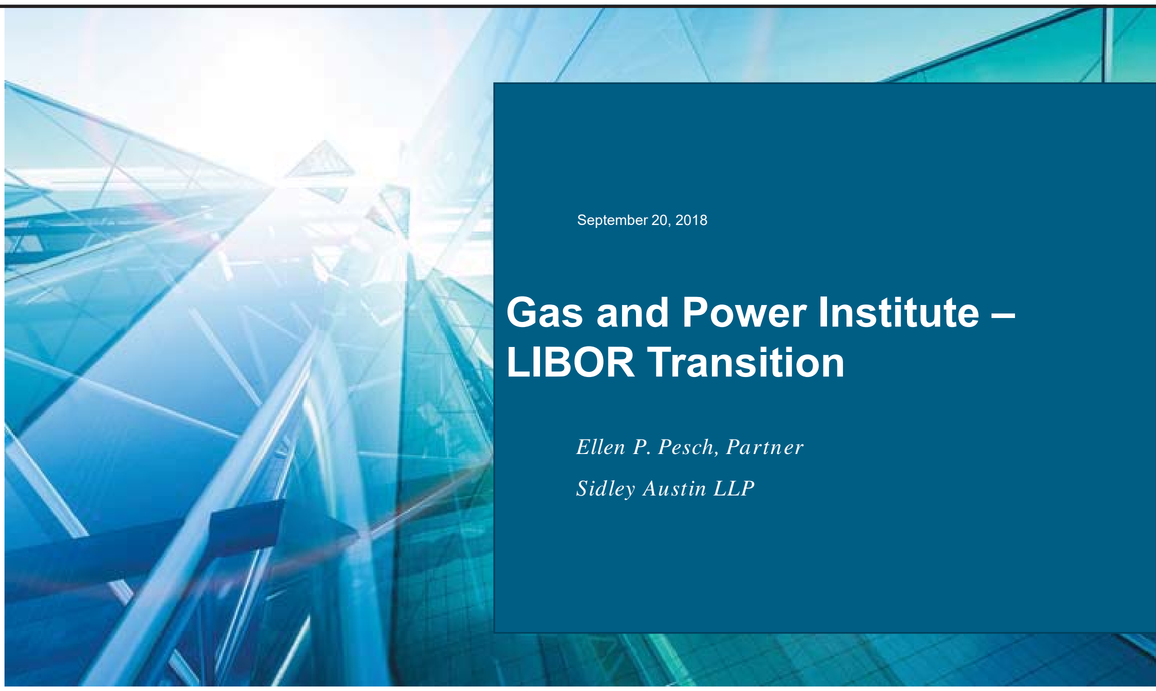

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Gas and Power Institute – LIBOR Transition

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LIBOR Transition - History

- Post 2008 Financial Crisis – LIBOR misconduct
- 2013 LIBOR became regulated by the Financial Conduct Authority (FCA) in UK and the International Organization of Securities Commissions (IOSCO) published Principles for Financial Benchmarks
- 2014 ICE took over administration of LIBOR from the British Bankers Association
- 2014 Federal Reserve Bank of New York convened the Alternative Reference Rates Committee (ARRC) to identify best practices for U.S. alternative reference rates
- June 2017 the ARRC identified the Secured Overnight Financing Rate (SOFR) as the preferred alternative to U.S. Dollar LIBOR
- July 2017 Andrew Bailey (Chief Executive of the FCA) announced that the FCA would no longer compel or persuade banks to submit quotes for LIBOR beyond 2021

LIBOR Transition - Today

- Various trade associations have formed working groups to consider implications of LIBOR transition for constituents:
  - ISDA, SIFMA, SIFMA AMG, LSTA, AFME, ICMA, SFIG, CREFC
- ISDA working groups are developing:
  - New fallback definition for SOFR and other replacement rates
  - Identification of trigger for when new fallback will become effective – permanent cessation of LIBOR (versus temporary disruption)
  - Development of methodologies to calculate adjustments (credit spread and term fixing) to minimize changes in valuations
  - Protocol that can be adhered to in order to amend ISDA documentation to implement new fallback definition, new trigger and adjustment methodologies
- ISDA protocol process will address ISDA based documentation, however, other documentation referencing LIBOR will need to be amended/modified independently in order to address transition issues – including fallback, trigger and adjustments

LIBOR Transition – what is SOFR?

- The Secured Overnight Financing Rate (SOFR) is a new risk-free rate that is:
  - Calculated and published by the Federal Reserve Bank of New York
  - Published daily at 8AM New York time each business day
  - Calculated based on a volume-weighted median of transaction-level tri-party repurchase (repo) agreement data collected from three components:
    - Rates for bilateral Treasury repo)transactions cleared through the delivery-versus-payment system offered by the Fixed Income Clearing Corporation (FICC)
    - Rates on overnight Treasury general collateral repo transactions
    - Rates for overnight, specific-counterparty tri-party general collateral repo transactions secured by Treasury securities.
- SOFR is a risk-free rate – so there is no credit qualify that is factored into the rate
- SOFR is calculated based solely on overnight rates, so there is no term duration that is factored into the rate – it is solely an overnight rate

LIBOR Transition – SOFR Implementation Timeline

- Federal Reserve Bank of New York commenced publication of SOFR – April 2018
- Infrastructure for futures and OIS trading in SOFR to be in place by 2^{nd} half of 2018
- Trading to begin in futures and/or uncleared OIS that reference SOFR by end of 2018
- Trading to begin in cleared OIS that reference SOFR to the current PAI and discounting environment by Q1 of 2019
- CCPs to being allowing market participants a choice between clearing new or modified swap contracts referencing SOFR into the current PAI/discounting environment or one that uses SOFR for PAI/discounting by Q1 of 2019
- CCPs no longer accept new swap contracts of clearing with EFFR as PAI/ discounting except for narrow, limited purposes by Q2 of 2021
- Creation of a term reference rate based on SOFR-derivatives markets once liquidity has developed sufficiently by end of 2021

LIBOR Transition - Implications

- LIBOR is used/referenced in a wide range of different financial products –
  - Swaps/derivatives contracts
  - Credit/financing agreements
  - Corporate notes and bonds
  - Securitization notes and certificates
- Different financial products contemplate different fallback methodologies – most of which were crafted to only address a temporary disruption in the publication of LIBOR –
  - Current ISDA definitions fallback to ‘reference banks’ rate
  - Many credit/financing agreements fallback to Prime rate
  - Many corporate notes and bonds fallback to a fixed rate based on the last published LIBOR rate
- Different products may fallback to different rates – creating unexpected basis risk – e.g. credit agreement falls back to Prime, but related interest rate swap falls back to SOFR

Title search: LIBOR and Letters of Intent

Also available as part of the eCourse
2018 Gas and Power eConference

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