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Libor Update: New SOFR Guidance, Fed Comments on Ameribor

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The Federal Reserve's Alternative Reference Rates Committee (ARRC) has released new guidance on transitioning away from the London Interbank Offered Rate (Libor) to the Secured Overnight Financing Rate (SOFR). But while SOFR is the Fed's preferred successor for Libor, Chairman Jerome Powell indicated last week that Ameribor also has a future as an alternative rate.

Recognizing that Libor's proposed end is a mere 19 months away, the ARRC released a list of best practices to help organizations accelerate their transition efforts. The ARRC began by clarifying its core guidance:

1. New USD Libor cash products should include ARRC-recommended or similar fallback language as soon as possible.
2. Third-party vendors relevant to the transition should complete all necessary upgrades to support SOFR by the end of 2020.
3. New use of USD Libor should cease, depending on specific circumstance in each cash product market.
4. For contracts specifying that a replacement rate will be selected following a Libor transition event, the determining party should disclose their chosen rate to relevant parties at least six months prior to the date that the rate becomes effective.

Additionally, ARRC identified a number of "transition milestones" that market participants should aim to achieve across floating rate notes, business loans, consumer loans, securitizations, and derivatives.

The committee recommends that financial institutions:

1. Take active steps to meet the timelines set out for the transition milestones
2. Establish clear internal programs to transition away from Libor
3. Keep aware of additional ARRC recommendations and have ongoing dialogue with key stakeholders to promote awareness of the transition.

That last point is important for corporate clients. Corporate treasury professionals should be having conversations with their banks to determine their next steps as they seek to establish a timeline for their transition.

POWELL ON AMERIBOR

In a written statement last week, Fed Chairman Jerome Powell commented on the suitability of Ameribor as a replacement to Libor. Asked by the U.S. Senate Committee on Banking, Housing and Urban Affairs whether he supports alternative benchmark rates other than SOFR, he replied that the Fed supports the work of the ARRC and views SOFR as a robust alternative that will help many market participants make the switch from Libor. However, he reiterated that moving to SOFR is voluntary and market participants should transition in the manner that is most appropriate for them, given their own circumstances.

On that note, he continued that Ameribor, a rate created by the American Financial Exchange (AFX), is “based on a cohesive and well-defined market that meets the International Organization of Securities Commission’s (IOSCO) principles for financial benchmarks.” Nevertheless, while he believes the rate is fully appropriate for banks when it reflects their cost of funding, he added that the rate is “may not be a fit for all market participants.”

AFX CEO Richard L. Sandor responded that Powell’s comments “reinforce the importance of choice” when it comes to the transition away from Libor. He added that Both SOFR and Ameribor “are complementary to each other” and offer robust alternatives as the market moves away from Libor.

These comments reflect those of Robert Owens, director of fixed income strategy for Farmer Mac, who commented on the AFP Conversations podcast last year that Ameribor is less of a competitor to SOFR and more of an alternative. “Obviously SOFR is the dominant alternative, but I think Ameribor has a nice place, especially in rural America,” he said.

Amol Dhargalkar, managing director for Chatham Financial noted that while it is difficult to say whether Ameribor will take off or not just yet—particularly for medium-sized and larger corporates—the comments by Chairman Powell could help in that regard.

Moreover, some market participants may favor Ameribor over SOFR due to some key similarities to Libor.

"Most corporates feel as though they will take the lead of their banks on the appropriate index," he said. "One of the benefits of Ameribor is that it represents unsecured borrowings between financial institutions—typically smaller ones, relative to the large investment banks that provide services to large multinationals. This more closely mimics the concept behind Libor itself, so banks may find it particularly valuable and interesting as a SOFR alternative. This is particularly true for smaller banks whose funding costs may not be best approximated by SOFR."

For more tips on how you can prepare for the end of Libor, be sure to visit AFP's Libor Transition Guide.

https://www.afponline.org/ideas-inspiration/topics/articles/Details/libor-update-new-sofr-guidance-fed-comments-on-ameribor