

Rates: Tainted Libor

The ultimate deadline for Libor isn't too far away and after that, it is far from clear what type of Libor will exist. The trick between now and then is to negotiate a path of least intrusion. But for now, get ready; the [Sonia's](#) and Ester's of this world are set to strut into town



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Libor may cease to exist after 2021

Regulatory authorities have had it in for the Libor benchmark rate, ever since the banking crisis. A decade on and we are at a point where the horizon sees the beginning of a move away from Libor to new risk-free rates (RFR), but the ultimate deadline is end-2021, and after that, it is far from clear what type of Libor will exist.

The trick between now and then is to negotiate a path of least intrusion. In the meantime debate continues on the methodology on the floating side of an RFR-referenced swap; a final decision here is central to kick-start volumes in the new RFR swap market.



Replacement to the Ibors will be risk free rates with an overnight tenor

Risk free rates (RFR) have been chosen to replace Libor and Euribor and “Ibors” of all guises. They have in common a reference point that is ultra-short in tenor. And by excluding (or at least minimising) credit risk, they can be properly deemed to be risk-free rates. The provision of submissions to Libor is only guaranteed through to end 2021; time is ticking.

➔ New reference rates have been chosen, and futures operate in the US and UK

The new reference rates have been chosen for the major global players, and both the UK and the US versions have futures capabilities. But hedging volumes done in the new risk-free rates to date are still quite low. Volumes in Libor, in fact, continue to grow despite its projected demise, and at this point remains the dominant reference for the vast bulk of interest rate swap trades.

➔ Efforts are being made to beef up volumes in the new swaps

Most market players are in a wait-and-see mode right now. In the US a concerted effort kicked off this month to encourage market players to beef up volumes in the new products spanning cash and futures markets. In the UK, there has been movement seen among some ALM players, with some preferring to exercise new swaps in SONIA.

For EONIA, an added urgency comes from the notion that it will not meet new EU Benchmark Regulation (BMR), effective from Jan 2020 (although a two-year extension has now been called for). The EMMI is endeavouring to make a hybrid Euribor BMR compliant, but either way, it is a tad inconvenient, to say the least, that the ESTER project is also the least prepared.

➔ Ongoing debate if the term RFR will be set in advance or arrears

In terms of reset in advance versus reset in arrears, in many ways the latter is a purer reflection of the floating rate position. A futures overlay can make the transformation implying derivation of forward looking RFRs. There is a debate in full flow on this front however. Many participants advocate for forward-looking term RFRs, where the RFR is set in advance, highlighting cash markets where parties may favour knowing interest payments in advance is important.

➔ A reset in advance Term RFR is most likely to help beef up volumes

If the reset (or compounding) in arrears (OIS-type) convention is acting to mute interest in new RFR swaps, then that likely nods in the direction of going with reset in advance as the adopted convention. The sooner that the appropriate methodology is settled upon, however, the sooner volumes will pick up, as that decision will likely decide the new benchmark IRS product on a global scale.

Bottom line

This is a massive item for attention in the coming years for all participants that have a link to current labor markets. And that extends beyond the financial markets to all types of consumer and corporate product that are currently referenced against the labor markets. Get ready; the [Sonia's](#) and Ester's of this world are set to strut into town

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