BMO IBOR Transition Office

IBOR Transition Newsletter

NEWSLETTER | JANUARY 2022

The purpose of this newsletter is to provide the latest updates and industry developments regarding the transition from Interbank Offered Rates (IBORs) to alternative reference rates (ARRs). In this issue, you will find summarized jurisdictional highlights from the global regulatory community, industry working groups, and various industry news sources.

UNITED STATES

- The U.S. Internal Revenue Service (IRS) and Department of Treasury published final regulations that provide guidance on the tax consequences of IBOR's transition to other reference rates. This regulation addressees the possibilities of contract terms modifications that could lead to a realization of income, deduction, gain or loss for income tax purposes or other tax consequences.
- The CME Group recorded that SOFR futures average daily volumes (ADV) have grown to 664,603 per day in January compared to 290,000 contracts per day on average in December 2021. In addition, Eurodollar, SOFR futures and options ADV at CME have grown to more than 4.6million contracts a day. These milestones indicate market participants are turning to CME Group for its deeply liquid SOFR future and options to hedge and manage risk.
- Some US regional banks have shown a preference for credit sensitive rates such as Bloomberg Short Term Bank Yield Index (BSBY) and Ameribor over SOFR. This preference stems from concerns around exposures if a tightening credit cycle lifts their borrowing costs.
- Ahead of the Federal Reserve's signal to increase interest rate, momentum has been building in futures linked to SOFR. Traders are now pricing in a full 25 basis point rate hike into March Fed-dated swap.
- Kroll Bond Rating Agency (KBRA) released a research report stating that commercial real estate will have most of its newly issued floating rate securities based on Term SOFR index rate. However, majority of the legacy floating rate LIBOR deals may not switch until closer to the planned LIBOR cessation date on June 30, 2023.
- The SOFR Academy featured insights on how banks can solve the SOFR credit-spread problem which centered around industry standard for pricing commercial loans. Banks are advised to incorporate an independently calculated and strongly defined credit sensitive spread to SOFR. This will help manage potential mismatches in funding costs and reduce conduct risks.
- Experts discussed in a panel organized by the Risk.Net on the idea of a multi-benchmark world in the future. The experts believe that there will be some use of credit-sensitive rates as this can provide compensation for broad credit risk. In addition, the experts believed most of the liquidity in cash and derivatives will be in RFRs by 2024.

CANADA

- The Canadian Alternative Reference Rate working group (CARR) published a white paper outlining recommendations and a timeline for the transition from the Canadian Dollar Offered Rate (CDOR) to the Canadian Overnight Repo Rate Average (CORRA).

INTERNATIONAL

- LIBOR finally takes a bow after being the most important number in finance for 52 years. LIBOR, which was widely used for setting interest rates from mortgages to school loans, has now been succeeded by Alternative Reference Rates (RFRs) endorsed by regulators. As at January 1, 2022, no new LIBOR transactions can be initiated and the publication of GBP, EUR, CHF, JPY LIBOR, as well as one-week and two-month USD LIBOR have now been ceased.
- The ISDA-Clarus RFR Adoption Indicator tracks how much global trading activity is conducted in cleared over the counter and exchange-traded interest rate derivatives (IRD) that reference the identified RFRs in six major currencies. The December 2021 data showed that JPY had the highest percentage of RFR-linked IRD DV01 executed as transactions with tenors longer than two years.
- The Financial Conduct Authority (FCA) announced that the majority of LIBOR panels have ended, and settings ceased or are permanently unrepresentative. The overnight, 1-month, 3-month, 6-month and 12-month US dollar LIBOR settings will continue to be published under a panel bank methodology until the end of June 2023.
- Interdealer trades have almost entirely referenced euro short term rate (€STR) and SOFR in euro/dollar cross-currency swaps while ditching legacy interest rate benchmarks. The head of the cross-currency basis swap desk at ICAP confirmed that until mid December, there were concerns around potentials for a two-tier market as there were lots of €STR versus SOFR and Euribor versus US dollar LIBOR. However, euros are currently trading 100% €STR versus SOFR.

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