FHLBank INDIANAPOLIS

Replacing LIBOR with SOFR

Important News

On Tuesday, January 15, 2019, FHLBank Indianapolis issued its first SOFR-indexed bond, the fourth SOFR issuance for the FHLBank System overall. Global regulators are pushing for LIBOR (the London Interbank Offered Rate) to be phased out by the end of 2021, and SOFR is the recommended alternative. The introduction of SOFR and transition away from LIBOR is a complicated process; below are some questions that are answered to help our members better understand these significant market changes.

What is SOFR?

SOFR is the Secured Overnight Financing Rate. It represents the cost of borrowing cash overnight collateralized by U.S. Treasury securities. It was first published in April 2018 by the Federal Reserve Bank of New York. SOFR is based on actual daily transaction volumes that are approximately $1 Trillion per day of Treasury repurchases as reported by the NY Fed.

What is LIBOR?

LIBOR is currently the most relied upon global benchmark for short-term interest rates, with over $200 trillion in financial assets tied directly to the rate. LIBOR has been published daily since the 1980s. It's based on the rates at which banks lend unsecured funds to each other in the London Interbank Market and is determined by daily surveying a panel of 16 banks what they charge one another to borrow without collateral.

The published rate is used to price a range of financial products such as derivatives, bonds, and loan documentation, as well as in consumer lending instruments such as mortgages and student loans.

Why is LIBOR going away in 2021? Why does the market need a new benchmark interest rate?

Since the financial crisis, new banking regulations have reduced much of the demand for bank-to-bank unsecured loans, which form the LIBOR benchmark rates. Without real transactions occurring, panel banks have to rely on expert judgment and internal models to form the rate they submit.

Survey banks, as well as global regulators, are uncomfortable given the low volume of transactions following the financial crisis and their heavy dependence on expert judgment for submission.

Why is SOFR important?

With concern about the sustainability of LIBOR beyond 2021, the market needs to transition to a different benchmark rate. SOFR is the preferred replacement by ARRC (Alternative Reference Rate Committee) – a group convened by the Federal Reserve to develop an alternative interest rate benchmark.

Why did the ARRC select SOFR? SOFR is based off *real transactions* from a robust underlying market. The Treasury repurchase market is a deep, liquid, and transparent market with thousands of participants. The transaction volumes underlying SOFR dwarf the volumes underlying LIBOR.

Source: ARRC (Alternative Reference Rate Committee) Frequently Asked Questions Version January 31, 2019

For additional information related to the LIBOR to SOFR transition, contact FHLBank Indianapolis Member Services 800.442.2568 or memberservices@fhlbi.com