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CFA Trending Topics

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SOFR: almost ready for prime-time

Key takeaways:

- SOFR (Secured Overnight Financing Rate) is widely expected to replace LIBOR and the transition appears to be accelerating.
- SOFR implementation is starting to be seen across multiple areas of the debt capital markets.
- The market may swing from LIBOR to SOFR more quickly than anticipated but the development of SOFR term rates and related derivatives products will be key.

SOFR is an overnight rate based on transactions conducted in the Treasury repo market, which is poised to join the list of benchmarks used with financial instruments. Recommended language to replace LIBOR with SOFR, should LIBOR be discontinued, is expected to be proposed by a special committee by the end of 2018.

After Fannie Mae issued the first SOFR linked note ($6bn floating rate note), the World Bank was first to hedge a bond issuance linked to SOFR ($1bn 2Y note using a SOFR to 3-month LIBOR swap). Expansion into other capital markets products like CDs by Credit Suisse ($100mm 6 month CD), commercial paper by Barclays ($525mm floating rate commercial paper), and GIC notes by MetLife ($1bn 2Y guaranteed floating rate note) highlight the continued progress, so a logical next step could be traditional corporates. Pricing of recent SOFR offerings appears to be roughly flat to 'LIBOR equivalent' offerings.

SOFR still remains an overnight rate, however and its full potential will only be seen once term rates and derivative products develop around the new benchmark, and broader market infrastructure gets upgraded to accommodate both primary and secondary markets for SOFR-linked products.