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Libor Showed its Weakness in Coronavirus Market Crisis.

The deadline for the phaseout of Libor at the end of 2021 will not be delayed and despite the effects of the COVID-19 pandemic, progress is being made on the switch to alternative reference rates.

That was the message of New York Federal Reserve officials in two webcast presentations Monday and Wednesday.

New York Federal Reserve President John Williams said Monday in a joint presentation with Bank of England Governor Andrew Bailey that the transition away from Libor "continues to be of paramount importance."

"The clock is still ticking," Williams said. "It's critical that regulators and institutions continue to work together to ensure they're all ready for January 1, 2022."

The No. 1 priority, according to Williams, "is to stop writing Libor contracts."

The London Interbank Offered Rate is a widely used benchmark for short-term interest rates based on data contributed by participating banks. It was tarnished by rate-rigging scandals.

Market participants who continue to use Libor are driven by nostalgia because it's not a robust reference rate, Williams said.

Bailey highlighted that weakness by discussing the recent market crisis that occurred as worldwide awareness grew of the impact of the pandemic.

The week of March 16 when central bank rates were at historically low levels, "over half of the 35 published Libor rates across all currencies contain no transaction-based submissions at all," said Bailey. Simultaneously, Bailey said, "Libor rates, and therefore costs with borrowers, spiked upwards."

In contrast, the Secured Overnight Financing Rate (SOFR), which is being promoted as an alternative to Libor in the United States, held its volumes and weathered the crisis.

David Bowman, senior associate director of the Federal Reserve, said during Wednesday's presentations that the SOFR market now accounts for over $1 trillion of transactions daily.

"It is produced in a transparent and direct manner," said Bowman. "It is based on observable transactions, not dependent on estimates like Libor or derived from some model."

The SOFR, which the Federal Reserve Bank of New York publishes on its website each weekday, represents the rate in the repo market the previous day. It is published in the morning and finalized at 2:30 p.m. Eastern time.

The New York Fed also publishes 30-day, 90-day and 100-day compound averages of SOFR.

The SOFR index, also published by the New York Fed, can be used to calculate a customized compound average over any period the user chooses.

“People forget that the reason that we have to go through this transition is because of the way the financial system structured itself,” said Bowman. “It put far too much weight on a rate that was far too weak. And now we’re dealing with the consequences.”

John Gerli, chief capital markets officer of the Federal Home Loan Bank’s Office of Finance, said his experience with SOFR so far has provided him encouragement that the investor base may be broader than it was with Libor.

“Some of them have said that it’s a good substitute for repo, and it’s a cash and highly liquid marketplace,” Gerli said. “So I think from our perspective, at least in two years out [from the phaseout] the investor base here, may be broader.”

By Brian Tumulty

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