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Research & Publications

## LIBOR Reform Update

September 2022

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## Main Updates

- USD Libor cessation 30th June 2023
- Clarion – independent Eurodollar and SOFR listed option volatility surfaces
- Results of the LCH USD Libor conversion consultation
- Overview of CME plan and time line for Eurodollar Future and Option conversion
- SGD SOR Cessation and LCH conversion consultation

## Consolidated timeline

- 31st Dec 2021 – Last publication of CHF, EUR, GBP and JPY Libors
- 31st Dec 2021 – No new risk on USD Libor
- 3rd Jan 2022 – Last publication of EONIA
- Sep 2022 – CME to publish methodology for Eurodollar option conversion to SOFR
- Late 2022 – LCH to introduce a free and voluntary Libor/Libor and Libor/SOFR basis swap splitting facility
- April 2023 – Expected Eurodollar Future and Option conversion at CME
- April 2023 – Expected conversion of CME cleared USD Libor swaps to SOFR
- Weekend 21st April 2023 – LCH Libor/Fed Fund basis swap conversion
- Weekend 19th May 2023 – LCH Conversion of Cleared Libor swaps to SOFR
- 30th June 2023 – Last publication of USD Libor

## Market migration to Risk Free Rate (RFR) referencing derivatives

The SOFR first initiative<sup>1</sup> saw new risk move away from USD Libor from end 2021. This transition was seen first in the OTC space with listed SOFR volumes growing in recent months. As with the GBP/JPY/CHF/EUR Libor discontinuation of end 2021, Central Counterparty Clearing houses (CCPs) have proposed conversion approaches for cleared swaps. Similarly, CME has released initial details on how it will convert Eurodollar Futures and Options to equivalent listed SOFR positions

## LCH and CME USD Libor swap conversion

LCH have recently concluded a consultation on USD Libor conversion<sup>2</sup>. The outcome is similar to the GBP/CHF/JPY/EUR Libor CCP conversions of December 2021. USD Libor conversion at LCH will be processed in two tranches:

- Weekend 21st April 2023 – USD Libor/Fed Funds basis swap conversion
- Weekend 19th May 2023 – conversion of USD Libor swaps to USD SOFR swaps

The output of the LCH USD Libor conversion will be SOFR swaps – retaining the accrual periods of the original Libor swaps and incorporating the ISDA fallback spread to maximise cash flow continuity. Cash compensation will be applied for any remaining valuation differences. “Overlay” bookings will be used to ensure Libor exposure is retained until conversion date i.e. Libor fixings post LCH conversion but pre USD Libor discontinuation will still reference their intended Libor fixing.

Additionally – For Libor/SOFR and Libor/Libor basis swaps LCH’s conversion methodology would result in SOFR/SOFR basis swaps. LCH will introduce a free facility in late 2022 to voluntarily split Libor/Libor and Libor/SOFR basis swaps. As such LCH will not impose a mandatory basis swap splitting event.

**Fees**<sup>3</sup>– LCH will apply a monthly fee of \$5 per USD Libor contract for month end January, February, March and April 2023. There will be a conversion fee of \$30 per contract.

CME are expected to convert their cleared swaps in April, rather than the May date chosen by LCH, to avoid the operational overhead of simultaneous conversions.

## Exchange conversion of Eurodollar Futures and Options<sup>4</sup>

It is expected that CME will convert Eurodollar (ED) Futures and Options in April 2023 – in line with their OTC swap conversion. It will not be on the same weekend to minimise operational overhead.

The conversion will be on all open interest in CME ED Futures and Options beyond June 2023. April, May and June contracts would remain active – with all later dates being delisted.

Futures will be terminated and open positions converted on a one-to-one basis to equivalent month 3 month SOFR Futures – with a price adjustment of the ISDA fallback spread for 3M USD Libor (26.161bps)

Options will be terminated and open positions converted to options on 3M SOFR Futures with a 25bp higher strike – that is a standard/listed strike. Further details are expected in September.

## Clarion Analytics

The listed transition away from USD Libor has not been as immediate as for flow products in the OTC space, but SOFR Futures and Options volumes have seen rapid growth in the last few months and are now comparable with equivalent Eurodollar<sup>5</sup> contracts.

Post June 2023, ED Futures and Options effectively reference SOFR – and have the same implied volatility surface. However, there is currently a basis between ED and SOFR implied volatility surfaces, and this basis has widened several times this year.

Clarion has adapted to these changes – in particular the increased liquidity of SOFR listed options – with improvements to its analytics. Specifically, the pricing model for listed options now separately calibrates to exchange prices of ED and SOFR futures options, maintaining two distinct ED and SOFR volatility surfaces, accounting for the basis between them.

Whilst the pricing of ED options is unchanged, the enhanced functionality improves the pricing and risk for SOFR futures options.

## Singapore Swap Offer Rate (SOR) discontinuation and CCP conversion

The calculation of SGD SOR uses USD Libor fixings as an input, this complicates fallback methodologies as post June 2023 USD Libor fixings will no longer be available:

- As of Sep 2021 the market has moved to SORA for new risk - SORA is the recommended alternative to SOR<sup>6</sup>
- In line with the USD Libor cessation, the 30th June 2023 will trigger SOR fallback activation to the “Fallback Rate (SOR)”
- “Fallback Rate (SOR)” itself is an interim rate to be discontinued on the 31st Dec 2024
- Following this there is a further fallback to the “MAS Recommended Rate”<sup>7</sup>

For operational and risk management reasons<sup>8</sup> LCH will not implement “Fallback Rate (SOR)” for cleared SOR swaps, LCH are currently consulting<sup>8</sup> on a proposal to either 1. Terminate all SOR contracts pre 30th June 2023 or 2. Amend SOR contracts so that they do not reference SOR post 30th June 2023.

**If you would like to discuss any aspect of this update or want to better understand the updated Clarion Analytics, please contact:**

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## References

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8. LCH consultation on SGD SOR conversion <https://www.lch.com/membership/ltd-membership/ltd-member-updates/lch-consultation-conversion-outstanding-cleared-sgd>

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