THE DAILY CHECK-IN WITH GOLDMAN SACHS

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Liz Bowyer: Hi, Jason.

Jason Granet: Hey, Liz. How are you?

Liz Bowyer: Good, thanks. So the last time we spoke we talked about the massive effort underway to transition from LIBOR, which has long been the world's benchmark for short-term interest rates.

Recently, regulators provided more clarity on the end of LIBOR. Where do we stand now?

Jason Granet: Yeah, it's very timely. Obviously last Friday we got a huge slew of announcements that were actually the final clarity on the exact schedule of LIBOR going away. You know, when we last connected and we were talking about this, there were still some folks asking the question if this will happen, when it will happen. Well, that day has come.

And so if we back up, this was kicked off in 2017, this course to really end LIBOR rates here in 2021. And sure enough, here in March those announcements were made. I would say the one difference that's evolved over time is that the US dollar rates are going to be published until the middle of 2023, where the rest of the LIBORs globally will end at the end of this year. But there's real clarity now from the regulators to not use those rates after the end of this year. And I know we'll talk about it shortly, but that extra 18-month window is really meant to help wind down some of the legacy in older products for a safe landing on this whole transition.

Liz Bowyer: So what specifically will happen next?

Jason Granet: Sure. So where we're at is the final schedule has been laid out. For all the non-US currencies, at the end of this year, the LIBOR rates will stop being representative and no longer be able to be published in a way that's used by the market. The UK regulators have said they will consider some of them to be published in what they're referring to as synthetic, quote/unquote, manner that can help wind down legacy securities.

But for effective purposes, they're ending at the end of this year.

When it comes to US dollars, the same thing. At the end of this year, they will no longer be able to be used. But they will be continued to be published in the same manner until the middle of 2023, June 30th, 2023. And after that point, they will be declared officially non-representative, officially unable to be unused. And there's still some discussions between the UK and US regulators on how to effectively what to do after June of 23. It's possible that some of them could be produced to help legacy securities. There's still some conversations that are going to need to happen to see how big the legacy transition problem is at that time to figure that out.

Liz Bowyer: And how are global investors and markets responding to all of this?

Jason Granet: So investors and market participants really like clarity. And what we got here was clarity, a very clear schedule, very clear dates. People know exactly what's going to happen when, and so therefore markets like that. They like the certainty.

What we also got was there's some mechanisms to transition old stuff to new stuff. And there is a spread calculations. And we got all of those spread calculations, so not only do we have clarity on dates but there's also clarity around economics, around what the economic impact of this transition will be after the end of the year or after June 2023. So global markets really enjoy having that clarity and transparency. And so this will really allow all of the execution of the transition to happen, quite frankly, in a reasonably smooth manner.

Liz Bowyer: So describe the other benchmark rates that will replace LIBOR and how investors are thinking about those.

Jason Granet: All right, so here in the US, the benchmark rate that's been put forward by the Fed's working group, the Alternative Rates Reference Committee, or the ARRC, is SOFR, the secured overnight financing rate. We discussed that the last time I was here. That rate is an overnight rate linked to treasury REPO. It's effectively as close to what the system has to an overnight risk-free rate. And so there's been mechanisms and language and product design that's really across all the spectrums of products to help the market move and use those new rates.

And similar rates sponsored by the global central banks exist in the UK and Japan and Europe, etc. And so really this has been a public-private partnership between the industry and the official sector to work together to both announce all of these plans and also set the market up with the tools to use new things going forward.

Liz Bowyer: And what about the challenges that might come with the change in computation methodology of SOFR?

Jason Granet: Sure. So I think what you're alluding to there is there might be subtle differences between bonds and derivatives or loans and derivatives in the way they work out. Those markets independently have come up with some slightly better conventions that either work for their infrastructure or work for their constituents. And so when you have people who pair those things together, people who have derivatives that hedge, bonds or derivatives that hedge loans, there could be some residual basis positions that exist between those two. And that's one of the things that the industry is working through to see what standards and structures the different markets use. And that will tell us more about what that basis risk positions that we'll leave behind. But there could be some micro differences between the two that investors and market participants definitely need to be aware about.

Liz Bowyer: What's an example?

Jason Granet: One clear example is you have a corporation or a project that takes out a 5-year floating rate loan, but they want cost certainty. So they do a float-to-fixed swap to get a fixed rate for their 5 years of their project. They have a loan that used LIBOR. They now have a hedged derivative that used LIBOR, and they're perfectly matched.

As we go through the transition, if the loan and the standards in the loan market adopt one calculation methodology of SOFR -- for example, simple averaging -- and then you have the derivatives market adopt a separate or distinct calculation -- the derivatives market's moving to a compounded averaging -- you have a simple average versus a compounded average, and you might have a mismatch that could leave that corporation or that person running that project with a mismatch or what the market referred to as a basis position, a slight difference between the two. Whereas before in the LIBOR space they were perfectly matched.

Liz Bowyer: So Jason, it sounds like we have the dates, the new rates. What else needs to happen to move into the new post LIBOR world?

Jason Granet: Sure. So there's a couple things left on the table. Number one is the regulators have been very clear that things need to move now. There's been directives and communication that's come from them globally, so the market needs to start moving, you know, quite quickly.

The second item is that there might be a tail of items on the back end to reconcile. And so the different industry working groups and the market participants have been engaged on different pieces of legislation both at the state level and the federal level in the US, in the UK, in Europe, in other places that can really help to cut off any odd risks or things at the end.

You also have all the operational considerations of doing this transition. You know, I think about it as a very large corporate action. Things need to change. And so it's a situation where we need to actually go through the process to actually switch everything based on all the ways that the regulators have laid it out in this most recent announcement.

And then lastly, there's global considerations. As I highlighted, the US is on their schedule. The rest of the world is on a different schedule. And we then we haven't talked about necessarily there's other parts of the world that might not be changing the way in which they move these rates. And so there's going to have to be some marrying across the globe to make sure people are thoughtful, especially, you know, clients of ours that are really thinking global markets or global considerations.

Liz Bowyer: Thanks, Jason.

Jason Granet: Thanks, Liz. Great to see you.