No more Libor: what next for the financial industry?

RESEARCH PROPOSAL

Justification and focus of the research

Libor, the London Inter-Bank Offered Rate, is a floating benchmark interest rate at which major global banks can borrow unsecured funds from other banks (Nelson, 2019). Following the latest round of Libor reforms in 2013, it is now based on five currencies: the US dollar, the Euro, the Swiss franc, the British pound and the Japanese yen; and seven different maturities: the overnight/spot next, one week and one, two, three, six and 12 months, totalling 35 different Libor rates calculated and reported by the Intercontinental Exchange Benchmark Administrator (ICE BA) (Crispoldi, Wigger and Larkin, 2014).

In active use since the mid-1980s, Libor has come under intense media scrutiny following its use leading up to the global financial crash in 2008 (Mackenzie, Braithwaite and Alloway, 2012) and more recently, the manipulation of the Libor rate for profit by multiple global banks, known as the Libor Scandal (Vaughan and Finch, 2017).

Despite the monumental efforts of multiple regulatory agencies around the globe to reform Libor, a move that was originally thought the most favourable to avoid huge costs associated with changing reference rates systems and enforcing fundamental structural changes across the financial system, one fundamental problem remained: in response to fewer interbank unsecured borrowing transactions in recent years, Libor is increasingly reliant on 'expert judgement' rather than transactions (Held, 2019). Consequently, in 2017, efforts to reform reference rates shifted to finding multiple alternatives by the end of 2021, a timeframe deemed sufficient for banks to transition.

This has given rise to new reference rates: i) the Secured Overnight Financing Rate (SOFR), an interest rate that banks use to price US dollar denominated derivatives loans; ii) the Sterling Overnight Interbank Average Rate (SONIA), an interest rate paid by banks for unsecured transactions in the British sterling market; iii) the Swiss Average Rate Overnight (SARON), the overnight interest rate of the secured funding market for the Swiss franc; iv) the Tokyo Overnight Average Rate (TONAR), an unsecured overnight interest and reference rate for Japanese yen, and; v) the Euro Short-Term Rate (ESTER), the European Central Bank's overnight, unsecured reference rate for the Euro (Royal Bank of Scotland, 2019).

While these risk free rates (RFRs) offer a more nuanced and credible approach in the world of interbank lending, several commentators have noted that reform to financial benchmarks remains the biggest, and potentially most destabilising upheaval, in the banking world for decades (Martin, 2019). The complexities around SOFR highlight some of these issues. For instance, the US Federal Reserve's Alternative Reference Rate Committee (ARRC) recognises that cash markets want a forward term rate as no bank or borrower wants to calculate loan interest based on a daily historical rate, but this will not happen until a more liquid SOFR market develops (predicted to be the end of 2021). Moreover, SOFR will require a change to the architecture of loan credit agreements to take account of the spread adjustment mechanism for the difference between SOFR's near risk-free status and the risk portion of the lenders funding costs (Whalen, 2019).

The transition from Libor to the new RFRs is going to present a number of significant challenges for banks and their clients, which, if not appropriately navigated, could have substantial financial and reputational consequences. However, perhaps of most concern, is that banks appear to be reacting too slowly to the impending changes (Wyman, 2018). The empirical evidence on how banks are preparing for the transition is scarce, with no identifiable data available on market sentiment to the changes.

This report aims to fill this gap by providing the financial industry with its first piece of independent, empirical research into the cessation of Libor.

Aim of this research

There are six aims to this research:

1. To understand what the banks understand about how the financial system will change when LIBOR ceases to operate.
2. To understand what the banks know about the new reference rates being implemented.
3. To understand how well the banks are working with their clients to prepare for the change in system.
4. To understand which regions/sectors will be most impacted by a change in system.
5. To understand if banks and wider financial institutions have any contingency plans if there is no forward-looking term RFR.
6. To understand how the banks and their clients are preparing for the future after the new reference rate systems are fully implemented.

Scope of the research

TXF have the capabilities to conduct a global report that targets research participants in all regions, or it can target individuals in more specific regions.

A global study would likely consist of more general questions to ensure that the report remains relevant to a wider readership. Conversely, a study that looks more specifically at one or two regions will have the ability to explore more specific themes pertinent to those region(s).

In either case, the report will be a deep dive analysis that details the latest quantitative trends in the industry, complemented by qualitative data to explain ***why*** and ***how*** these trends are occurring. Wider literature will also be brought in to contextualise the findings.

Sample

TXF propose a global sample made up of:

- 50 banks
- 50 clients of the banks

However, the sample of respondents to take the survey will be driven by the client. TXF have a considerable network of people we can access to complete the data.

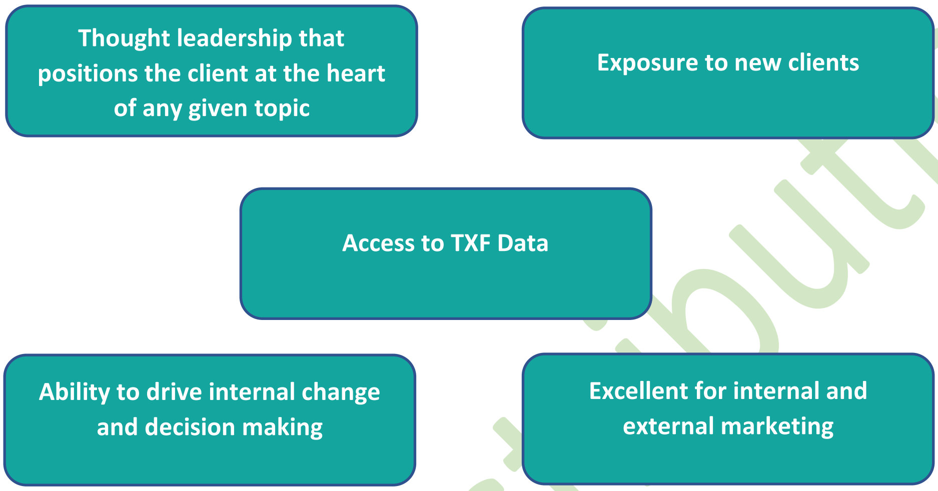
Additional benefits to the client:

These include:

- Where appropriate, TXF Data will be included to supplement the final report
- Exclusive rights over *all* the content
- A company logo on the front cover and all relevant inside pages
- A foreword written by the client, with a high resolution picture and an electronic signature included
- The opportunity to co-present the report at a TXF event of your choosing

- TXF will deliver an internal presentation to the client
- TXF will print off 50 hard copies of the report for the client
- TXF will distribute up to 50 hard copies at our events
- A feature length news article conducted by a TXF reporter that goes out to our full subscriber base.
- An opportunity to be interviewed as part of TXF's daily podcast that goes out to all our listeners.

Benefits of the final report



Partnering with TXF

- The client will be the sole proprietor of the research report. They will have complete freedom to distribute the report as they see fit and will have the opportunity to present the findings at a TXF event of their choosing.

- TXF will act as the independent research company for the client. This will give the final report greater credibility and transparency (i.e. no research bias).

- As the research firm, TXF will take on full responsibility for conducting the data collection and writing the report. This will ensure that client do not have to spend time with the project management side of doing the research.

- However, while TXF will be responsible for managing the research, the client will have a significant say in the development of the data collection tools and in the write up of the final report. The client will also have the final say on the design of the report.

- Through TXF's contacts, the client will be able to access a far wider network of contacts that the client does not have access to. This could lead to new client opportunities.

- The research will be conducted by Dr Tom Parkman, the Head of Research at TXF. Tom has 10 years of experience conducting research and is very experienced at producing detailed, insightful and innovative research reports in the finance industry.

Proposed timeline[1]

MONTH 1

Data preparation: The client and TXF work in collaboration to develop the survey questions and interview topic guide.

MONTH 2 **MONTH 3**

Data collection: TXF will be responsible for collecting of all the data (both quantitative and qualitative). TXF will give weekly updates to the client on the progress of data collection.

MONTH 4 **MONTH 5**

Data analysis and write up: TXF will analyse all the data and will present the findings to the client for review. TXF will produce 3 iterations (the third will be a graphically designed version) of the report which the client will have the opportunity to read and make comment.

MONTH 6

Media launch and release: TXF will work with the client to implement a social media/press campaign to promote the report. A press day can also be arranged to officially launch the report.

[1] This timeline can change based on the demand of the research but broadly speaking, it shows the typical life cycle of a research project from conception to launch.