SOFR Conversion: It's on for 2020

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From 10/17/20 on, all cleared swaps and swap futures will change:

- PAI will switch from Fed Funds to SOFR
- Eurodollar Futures will continue to trade, subject to fallback triggers—at which point ED$s and ED$ options will convert to SOFR.
- Cleared swaptions, at this point, will be liquidated/PV'd—though discussion continues.
- Cash flow discounting will switch from OIS/FedFunds to SOFR

11/27/2019 13:24	LIBOR	OIS/ FedFund	Treasury	SOFR	SOFR-FF (bp)
2y	1.6204	1.3459	1.6130	1.3926	4.6689
3y	1.5764	1.3155	1.6000	1.3503	3.4783
4y	1.5681	1.3133	1.6060	1.3383	2.5025
5y	1.5743	1.3209	1.6140	1.3373	1.6368
7y	1.6084	1.3559	1.7000	1.3655	0.9670
10y	1.6917	1.4388	1.7620	1.4403	0.1553
15y	1.7974	1.5431	2.0090	1.5303	-1.2866
20y	1.8558	1.6008	2.1320	1.5709	-2.9883
30y	1.8752	1.6174	2.2550	1.5731	-4.4314

← Zero Curves illustrate the impact of change in discounting. As of now, < 12y cash flows will be discounted at a HIGHER rate, and longer-dated cash flows at a lower rate.

A 'bullet 10yr' with ~4bp higher discounting rate will roughly shift DV'01 by $1600/bb. No big deal.

Our concern / interest is liquidity. We are highly skeptical of liquidity past the 2-year point of the SOFR curve. In the "First transition stage" (convert PAI and discounting), there will be a few weeks of headache, but this is a change for derivative users by derivative users. ***The big problems start at LIBOR cessation; when Rates/Coupons/Cash Flows are entirely SOFR-based.***

We are advocating, especially to "Key Rate Duration" hedgers, to adopt a discount curve that optimizes for LIQUIDITY in the underlying hedge instruments. Today, that curve looks like:

	Non-Bank Financial Entities	Banks Pressed for SOFR Use (Libor redux)
0-18mos	Eurodollar Futures	SOFR Futures
18m-3years	Eurodollar Futures	Eurodollar Futures (or 2yr TU Futures)
5-years	FV Futures	FV Futures
7-years	TY Futures	TY Futures
10-years	Ultra 10yr Futures	Ultra 10yr Futures
15/20-years	US Futures	US Futures
30-years	WN Futures	WN Futures

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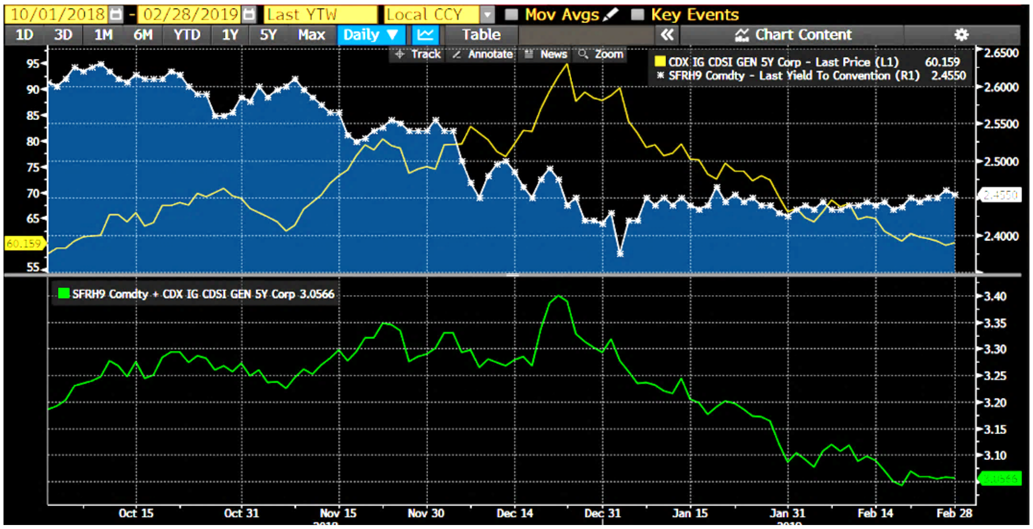
Expect SOFR+IG to become core rates to restore credit sensitivity to borrowing and lending.



Cost of Funds Equations, today, look like:

→ **3mLIBOR + 100 = 2.90**

Should become:

→ **3mSOFR + IG +x = 2.90**

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