This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers visit https://www.djreprints.com.

https://www.wsj.com/articles/sofr-leads-race-to-replace-libor-as-interest-rate-benchmark-11645408905

FINANCE

SOFR Leads Race to Replace Libor as Interest-Rate Benchmark

Sales of corporate loans and derivatives tied to rate have picked up, with Crocs among recent issuers

Borrowers such as Crocs are accelerating the shift away from Libor toward the Secured Overnight Financing Rate.

PHOTO: ANDREY RUDAKOV/BLOOMBERG NEWS

By Mark Maurer Follow

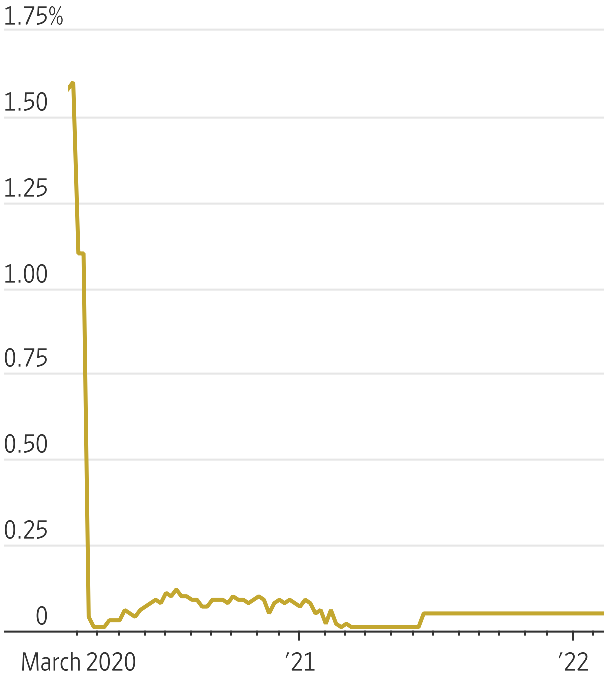
Feb. 21, 2022 8:00 am ET

U.S. companies and financial institutions are starting to settle on a new interest-rate benchmark to replace the troubled London interbank offered rate, which underpins trillions of dollars of financial contracts.

Sales of corporate loans and derivatives tied to the Secured Overnight Financing Rate, or SOFR, have soared in 2022, with borrowers including Crocs Inc. and NortonLifeLock Inc. accelerating the shift away from issuing new debt tied to Libor.

Large U.S. financial institutions, meanwhile, have largely replaced Libor with SOFR—regulators' preferred choice—for matters such as low-rated corporate loans and derivatives on future debt sales, analysts said.

Secured Overnight Financing Rate(SOFR)



Source: FactSet

Financial authorities started phasing out Libor in 2017 after the discovery that traders at large banks manipulated the rate, which helps set borrowing costs on financial contracts such as mortgages and corporate loans. Starting this year, U.S. banks can't issue any new debt linked to Libor, while around $200 trillion of existing interest-rate derivatives and business loans tied to the benchmark are set to expire by June 2023.

Regulators have worked with banks to promote broader adoption of SOFR. But the changeover has been slower than some expected, raising concern that an unruly transition would spark legal conflicts and spawn a complex mix of competing benchmarks.

Companies, banks and traders said they picked SOFR—which is based on the cost of transactions in the market for overnight Treasury repurchase agreements—in part because its stability during the Covid-19 pandemic's market swings demonstrated it is robust enough to support large numbers of financial arrangements.

“There seems to be a clear No. 1 candidate for most deals,” said Amol Dhargalkar, managing partner and global head of corporates at Chatham Financial, a financial-risk adviser.

SOFR has gained traction since a Dec. 31 deadline that prohibited U.S. banks from issuing new debt tied to Libor. U.S. companies in January sold 61 leveraged loans tied to SOFR totaling over $66 billion, according to Leveraged Commentary & Data, a unit of S&P Global Inc. That is up from around $3.9 billion raised across four deals in December.

Shoe maker Crocs said last month it sold a $2 billion SOFR-based leveraged loan to acquire Hey Dude, a casual-footwear brand, for $2.5 billion in a deal that closed last week. Crocs decided to switch to SOFR because "it's what has been dictated by the market," said Chief Financial Officer Anne Mehlman.

NortonLifeLock, a Tempe, Ariz.-based cybersecurity software provider, sold in January a $3.69 billion loan to fund its merger with Avast PLC, which is expected to close in April. NortonLifeLock CFO Natalie Derse said primary lender Bank of America Corp. advised the company to switch to SOFR, citing its traction in the market.

Crocs sold a $2 billion SOFR-based leveraged loan to fund an acquisition.
PHOTO: SCOTT OLSON/GETTY IMAGES

NortonLifeLock plans to switch over its remaining $2 billion in Libor-linked debt when it refinances, or pays it off and needs new loans, said Ms. Derse.

"We were OK with Libor," she said. "If we were in complete control, I don't know that we would have pushed for a change from Libor."

The weekly count of derivatives trades tied to SOFR surpassed that of Libor for the first time in the week ended Jan. 21, when the former totaled 8,200 compared with the latter's 6,815, according to a Chatham Financial review of market data.

Average daily trading of SOFR-based derivatives has grown as well. Over $1.4 trillion of futures and options contracts tied to SOFR changed hands daily during the month through Feb. 15, according to exchange operator CME Group Inc., compared with $237.6 billion in February 2021.

Some small or midmarket businesses are considering other benchmarks, such as the Bloomberg Short Term Bank Yield Index, known as BSBY, and American Financial Exchange's Ameribor, which they say better reflect lenders' funding costs and account for the risks from short-term lending.

BSBY derivatives trades totaled 21 in the week that SOFR first topped Libor. A spokeswoman for American Financial Exchange said the electronic marketplace didn't have a tally of the loans tied to the rate, but said Ameribor is a "true plug-and-play" replacement to Libor.

Some borrowers have held on to Libor, despite the Dec. 31 deadline. Last month U.S. companies launched 10 leveraged loans tied to Libor, seeking to raise $2.9 billion, on top of $9.9 billion from the previous month.

Most of the Libor-linked leveraged-loan transactions this year were so-called add-on loans, in which companies raise additional funds as part of an existing borrowing contract. Companies can also issue Libor-linked debt established before 2022 but set to close this year.

Companies with loans that expire before the June 2023 deadline—when products both existing and new must cease referencing Libor—will likely look into refinancing debt at a SOFR rate, said Jamie Spaman, managing director at the advisory firm and investment bank Stout Risius Ross LLC. Those whose loans don't expire before then might still wait to evaluate their options.

"It's still a little bit of wait and see," he said.

—Sebastian Pellejero contributed to this article.

Write to Mark Maurer at mark.maurer@wsj.com

Appeared in the February 22, 2022, print edition as 'SOFR Leads Benchmark Contest.'

Copyright © 2022 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers visit https://www.djreprints.com.