How Your Institution Can Hedge Without SOFR

hedging LIBOR SOFR

Summary: LIBOR was retired for new contracts at the end of last year. But, many community financial institutions have not started using SOFR, the recommended guidance of the Alternative Reference Rates Committee. Are you one of those institutions? Let's explore why some institutions are hesitant to transition to SOFR and examine another replacement index option.

Washington state operating room nurse, Florence "SeeSee" Rigney finally retired last year, at the age of 96Ys old. She was the oldest working nurse in the US. Her career spanned seven decades and still allowed her time to raise two children. She often clocked three miles during her shifts walking to and from operating rooms and actively helping out with other tasks. She first tried to retire at age 65, but was back to work six months later. It is not always easy to retire!

Many bankers feel that way about the retirement of LIBOR. After 35Ys of use, LIBOR has officially been retired, at least for new contracts. But, not all institutions are following the Alternative Reference Rates Committee's (ARRC) guidance to use SOFR. Why is that? We answer that question and help direct you to the right replacement index today.

Why are some community financial institutions (CFIs) hesitant to transition to SOFR?

1. Unlike LIBOR, the rate for SOFR is not known in advance. If interest is paid monthly, loan operations teams will need to wait a month for the interest accrual calculation, and that creates uncertainty for some bankers.
2. The calculation is not as simple to understand as LIBOR. This would not be an issue, if the calculation was updated automatically in the core banking system. But, that is not currently the case.
3. Some core systems are not updated yet to calculate compounded SOFR or handle the distinct SOFR documentation. This means that rate calculations and some documentation must be handled manually. With manual calculations, errors might increase and operations might become more time-consuming.

What alternative index can be used today?

While core systems are getting updated and bankers are getting more familiar with the ins and outs of SOFR, fed funds is a good alternative index. It has legacy documentation and this index is already established in most systems that have used LIBOR. Vendors understand it, so it can be used immediately.

If your customers want a fixed rate as interest rates rise, fed funds will allow you to easily hedge right now to satisfy your customers' needs. Then, when the challenges have been resolved with SOFR, you can easily transition to it, if desired.

Case Study: CFI uses fed funds index rate

We had a customer come to us recently with a hedging need, yet was hesitant about SOFR. We provided a hedge using fed funds, which made the deal easy for our customer and their client was happy to get a fixed rate. A true win-win situation.

If your customers are asking for fixed loans, but you don't want to hedge using SOFR yet, you don't need to. Fed funds is an easy way to provide your customers with what they want. Then, once SOFR is integrated into your core systems with documentation and an automated rate calculation, we can help you with that too. Our hedging solutions include both fed funds and SOFR, so we understand SOFR guidance and can walk you through the process, whenever you are ready.

HOW DO INTEREST RATE SWAPS BENEFIT MY INSTITUTION?

Business clients are expecting long-term, fixed rates from their financial institutions. See how you can meet both your needs and your borrower's needs with an interest rate swap using Borrower's Loan Protection® (BLP). See how today.

ECONOMY & RATES

Rates As Of: 03/23/2022 08:50AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	0.51	0.16	0.45
6M	0.96	0.27	0.77
1Y	1.53	0.53	1.14
2Y	2.16	0.73	1.43
5Y	2.38	0.66	1.12
10Y	2.37	0.54	0.86
30Y	2.59	0.43	0.69

FF Market	FF Disc	IORB
0.33	0.50	0.40
SOFR	**Prime**	**OBFR**
0.28	3.50	0.32