Comparing LIBOR to SOFR

The Alternative Reference Rates Committee (ARRC), a group of private-market participants convened by U.S. regulators to help facilitate the U.S. dollar LIBOR (London Interbank Offered Rate) transition, recommends the Secured Overnight Financing Rate (SOFR) as the replacement for USD LIBOR. Likewise, ISDA ("International Securities Dealers Association") selected SOFR as the replacement rate for LIBOR swaps in the derivatives market.

There are some key differences between LIBOR and SOFR which are important to understand:

LIBOR	SOFR
• Unsecured rate • Various maturities • Built-in credit risk component • Partially transaction based • $500 million underlying transactions	• Secured rate • Overnight only, for now • Essentially, a risk-free rate • Wholly transaction based • $1 trillion underlying transactions

While SOFR is relatively new, it is a market rate based on collateralized transactions in the U.S. Treasury Overnight Repo market. In contrast, LIBOR is based on wholesale unsecured pricing (actual and estimated) for inter-bank lending transactions. Although generally correlated, historical comparison of the two rates demonstrates that generally SOFR is lower than LIBOR. Both benchmark rates can be hedged using interest rate swaps.

As the chart below shows, SOFR has steadily gained traction in the cash and derivatives markets. This momentum is expected to continue through the next year as lending is increasingly done with reference to SOFR. The first major shift has already occurred at M&T, as we began offering Residential Mortgages referencing a SOFR index rather than a LIBOR index on September 1st, 2020.

The ARRC recommends that market participants include robust fallback language in LIBOR-based contracts, including loans, bonds, securitizations, and leases to help assure a smooth transition to an alternative benchmark interest rate upon the anticipated cessation of LIBOR.