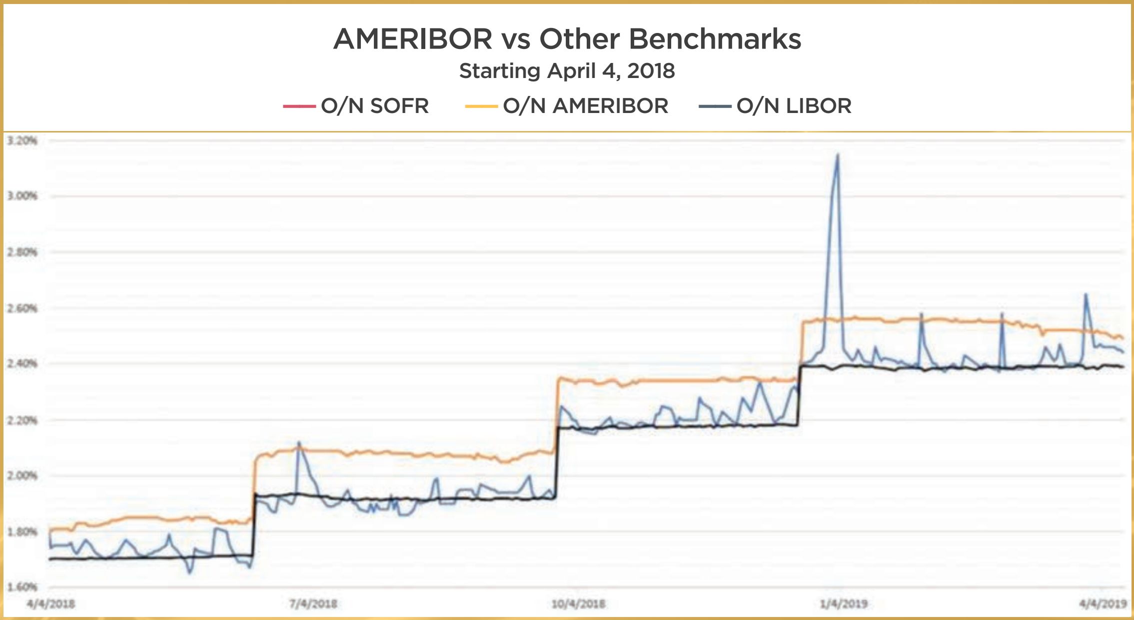
Gaining SPEED

More corprorates are using Ameribor, a Libor replacement

JOHN HINTZE



Source: Bloomberg.

Corporate finance executives may soon bankers pricing loan products via a new benchmark—and it may not be the much-ballyhooed one they are developing. The lesser known Ameribor may turn out to be more popular than the bank-created SOFR.

Ameribor users cite its cheaper costs relative to SOFR, the Secured Overnight Funding Rate created specifically to replace the London Interbank Offered Rate, the benchmark interest rate for upwards of $20 trillion in floating-rate financial products.

The Alternative Reference Rate Committee (ARRC) was tasked by the Federal Reserve Bank of New York with developing SOFR, and the nascent benchmark has received plenty of attention. Less attention has been paid to the rapid growth of the American Financial Exchange (AFX) and its floating-rate benchmark, even though it has already been used to price corporate loans.

Partly that is because the IOSCO-compliant Ameribor benchmark is aimed at regional and community banks, and the loans they've made so far have been in the millions of dollars rather than billions. For example, Alabama's ServisFirst Bank recently inked an $8 million commercial real estate loan over Ameribor that matures in five years and amortizes in 15 year. President and CEO Tom Broughton said the bank has also used the benchmark to price lines of credit over $10 million.

Numerous large financial institutions, including Fannie Mae, Wells Fargo and MetLife, have issued notes priced over SOFR. Those short-maturity deals have been for several hundred million dollars and some for more than a billion.

One of the few corporate borrowers to issue debt priced over SOFR, Toyota Motor Credit Corp., the financing arm of Toyota, issued $500 million in three-month commercial paper last October. Nicholas Ro, the company's treasury national manager of sales and trading, described the offering as a test to get feedback from its investors regarding how they "feel about the alternative reference-rate transition, and to determine what role TMCC can play."

So far, no deals comparable in size to TMCC's have been priced over Ameribor.

One corporate that is familiarizing itself with AFX is Deere & Co. The giant farm equipment manufacturer recently joined AFX at the holding-company level, suggesting its treasury may use the exchange as a vehicle to invest cash. The company did not respond to requests for comment.

AFX currently has 116 bank members and 25 nonbanks, which except for Deere & Co. are comprised of insurance companies, broker-dealers and asset managers. An additional 556 banks have access to the exchange through correspondent bank relationships.

Each of the member banks so far has less than $150 billion in assets. Regional and community banks appear to be attracted to Ameribor in part because SOFR presents risks that the largest banking institutions can more easily hedge. Richard Sandor, who launched AFX in 2015, noted that SOFR is generated from thousands of overnight repurchase-agreement (repo) transactions, a global market impacted by factors outside the United States such as credit issues of foreign banks lending in U.S. dollars. Ameribor, on the other hand, is generated from funding transactions between U.S. institutions and is designed to more accurately reflect their cost of funds.

"Ameribor is not a big bank tool; it's meant for the regionals," said Sandor, who developed the first interest-rate futures contract in the 1970s and later was instrumental in setting up climate-related exchanges in the U.S. and elsewhere.

Another significant benefit of Ameribor is that it is generated from unsecured transactions with credit risk, whereas repo transactions behind SOFR are secured. That's potentially a big problem for banks during times of financial stress, since credit risk will prompt investors to flock to secured investments such as repos, tightening SOFR, while their funding costs will likely increase.

"In September 2008, Libor increased by more than 500 basis points, and at the same time the repo rate dropped to near zero," Broughton said, adding that had SOFR been in effect in 2008 banks' loans would have been significantly underpriced while their cost of funds would have skyrocketed.

Broughton also pointed to SOFR volatility toward year-end 2018, when there was a shortage of treasury bonds. A Wall Street Journal article noted that the repo rate settled Dec. 31 at an all-time high of 5.149 percent, after hovering around 2 percent since the previous April. On the same day SOFR moved to 3 percent from 2.46 percent the day before. The article added that if "SOFR proves unusually volatile or hard to predict, it would diminish the benchmark's appeal to companies that are considering tying their borrowing costs to it."

Similar to SOFR, Ameribor is an overnight rate, so borrowers will only know their final rate at the end of the loan period. Most corporate borrowers, however, are used to Libor's term structure, which enables them to know precisely what their payment is at the end of each term—three-month LIBOR is common among commercial loans.

The major derivative exchanges such as the CME have nurtured markets in one-month and three-month SOFR futures since last summer, creating building blocks on which to build term versions of the benchmark. Volume in those transactions has leaped this year, a positive sign for term SOFR as well as Ameribor, which plans to piggyback off the success of SOFR futures.

Sandor said the plan is to launch Ameribor futures in the third quarter of 2019 that essentially replicate the CME's SOFR futures. "We're at the beginning of working on a term structure," he said. "We think the SOFR architecture is very good."