

## LIBOR Sunset & a SOFR Horizon – What Lies Ahead?

The London Interbank Offered Rate (LIBOR) is being phased out in the U.S. and replaced with a new benchmark rate, effective June 2023. The LIBOR index has had a long run as the dominant benchmark for dollar-denominated derivatives and credit products, but here's what you need to know about its replacement – the Secured Overnight Financing Rate (SOFR).

### Sun setting on LIBOR

The LIBOR index is made up of five currencies: the U.S. dollar, the euro, the British pound, the Japanese yen and the Swiss franc. The rate is primarily based on survey estimates from major global banks, rather than actual transactions.

In 2012, it became apparent that some institutions were altering data to improve profits from their LIBOR-based derivatives products. Ultimately, British regulators announced they would stop requiring banks to submit lending information after 2021, prompting a global search for an alternative index. In 2017, the Federal Reserve assembled the Alternative Reference Rate Committee

(ARRC) to establish a replacement for the U.S., and SOFR was selected as the new benchmark for dollar-denominated contracts.

### SOFR emerging on the horizon

SOFR is based on observable data from transactions in the Treasury repurchase market, where there is extensive trading versus estimated borrowing rates. SOFR will become the nation's new benchmark rate for pricing business and consumer loans. The "overnight" component of its name refers to the rate large financial institutions pay for other overnight loans. Financial institutions lend money to each other using Treasury bond repurchase agreements, or "repos." These agreements let banks make overnight loans to satisfy liquidity and reserve requirements using Treasury bonds as collateral. By using actual transactions, SOFR will be more reliable than LIBOR and less vulnerable to insider manipulation.

LIBOR and SOFR differ in other ways, starting with loan type. LIBOR represents unsecured loans, while SOFR is backed by Treasury bonds



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and, therefore, is arguably risk-free. Additionally, LIBOR has over 30 different rates, whereas SOFR currently publishes only one rate based on overnight loans.

### What lies ahead?

The two benchmark rates will coexist initially; however, SOFR will eventually supersede LIBOR for investing and lending. Many financial institutions have already begun transitioning investments and consumer products to SOFR. Trillions of dollars' worth of LIBOR-based contracts still exist, some of which won't mature until after the 2023 sunset date.

Regulators encourage financial institutions to prepare by:

- Including a "fallback" clause in all new contracts, outlining how the difference between SOFR and LIBOR will be calculated.
- Determining LIBOR risk exposure and using that analysis to develop a transition plan.

It's time to get started. The sun is slowly setting on LIBOR. Catalyst Strategic Solutions can help you with this transition. For more information, [contact our team of experienced ALM consultants](#) today or call 800.301.6196.

## Get a Jump on 2022... ...with Catalyst's Upcoming Webcasts

What does the future hold for credit unions? Catalyst Corporate is hosting two complimentary financial webcasts to help you answer that question!

### Interest Rate Derivatives Overview

December 2 | 2 p.m. Central Time

Derivative hedging can allow you to maximize loan portfolio size, asset growth and earnings goals, without some of the downsides of other risk management tools. Find out how to use this tool to your advantage in this webcast. Eligible participants will receive 1 CPE credit.

### Insights & Outlooks 2022

December 16 | 2 p.m. Central Time

This economic webcast will look at key indicators, such as employment, inflation, the financial markets, and consumer spending, and their impact on credit union loan demand, investments, liquidity, pricing and more.

To register, visit [www.catalystcorp.org](http://www.catalystcorp.org).

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## Are You Moving Forward with a Faster Payments Strategy?

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Individuals and businesses want to send and receive money at the click of a button. In fact, two out of three consumers and three out of four businesses think it's important that their financial institution offer faster payments, according to a 2020 Federal Reserve survey.

Faster payments are quickly becoming the expectation, with new use cases for the various faster payment technologies found almost daily. Gig workers are already one of the greatest beneficiaries. For example, food delivery services, such as Uber, GrubHub and DoorDash, are accessing these payment channels to pay their drivers at the end of a shift. That means workers can immediately cash out their earnings rather than wait for a weekly direct deposit. But there are so many more applications, from receiving regular retirement distributions to invoicing.

One option for meeting this demand by consumers and businesses is offering instant payment services using the FedNow<sup>SM</sup> Service, which is set to launch in 2023. Currently under development, FedNow is the Federal Reserve's 24/7/365 instant payment service that will aim to provide safe and

efficient real-time payments for financial institutions across the United States.

As a pilot participant in the Federal Reserve's FedNow program, Catalyst Corporate is actively providing design input on credit unions' behalf, working toward pilot launch of the service in 2022 and the live service in conjunction with the Federal Reserve in 2023.

The time to start preparing for the FedNow Service is now. But where do you begin? The Federal Reserve suggests three steps to get you started on your path to instant payments. They are:

- Understanding the demand for instant payments
- Assessing member needs
- Starting to build a business case

Research and advance planning will ensure your credit union understands its member needs and doesn't fall behind the competition.

Catalyst Corporate wants to be your one-stop shop for all faster payments resources and solutions. Just as Catalyst Corporate currently manages traditional transactions and settlement for checks, ACH, and wires,

we are now actively building connectivity to and/or establishing automation for the FedNow Service, P2P and The Clearing House (TCH) real-time payments. So no matter how your member presents a payment, Catalyst Corporate will ultimately be able to handle exchange of that transaction, as well as settlement with the financial institution on the other side.

Establishing connectivity to these platforms is simply the groundwork, though. The real differentiators will be found in the value-added features Catalyst Corporate is building into its payments system. Features currently on Catalyst Corporate's roadmap include: request for pay, e-invoicing, QR code functionality, and ISO 20022 capabilities.

It's time to develop a faster payments strategic plan, and Catalyst Corporate can help. For more information about P2P, The Clearing House RTP<sup>®</sup> Funding Agent Service or FedNow Service - including serving as a FedNow pilot credit union - **contact us** today: 800.442.5763.

### New Funding Agent Service Now Live on RTP Network

Catalyst Corporate's Funding Agent Service is now live on the RTP<sup>®</sup> network, the real-time payments system from The Clearing House. The service facilitates comprehensive 24/7/365 funding management for credit unions on the RTP network. Learn more: [www.catalystcorp.org](http://www.catalystcorp.org).