To: *ARRC Members*

Since you may be fielding questions about the recent move in repo rates, I wanted to give you some perspective.

To get right to it – an average of SOFR, which is the rate that is actually used in the marketplace, remains very stable. Even with the recent movements in rates and today's print, we calculate that a 3-month compound average of SOFR only rose 2 basis points compared to rates last week. By contrast, three month LIBOR rose 4 basis points relative to rates last week. Also, these moves are not specific to SOFR, the same movements were seen in other repo rates produced by FRBNY and larger moves were seen in DTCC's GCF rate and BNYM's Treasury repo rate. SOFR has accurately reflected repo market conditions, which is what it is intended to do. And the existence of SOFR derivatives has helped market participants to hedge some of the volatility – my understanding is that activity on CME SOFR futures was fairly high yesterday.

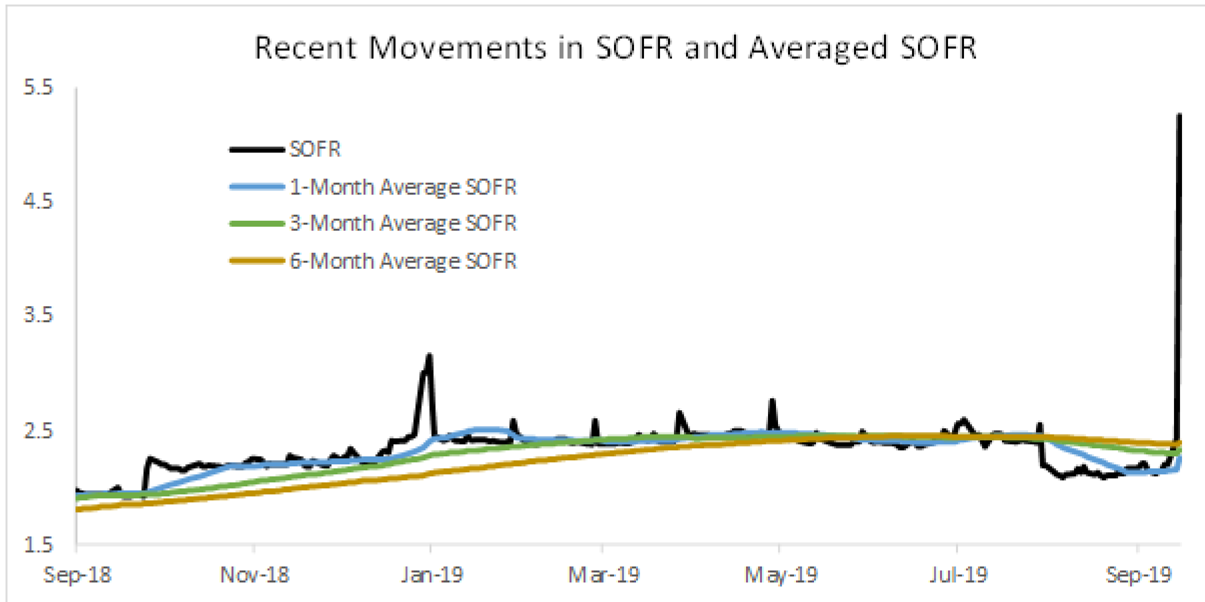
The ARRC always understood that daily rates are volatile and that that is why markets use averages of overnight rates. We will be updating the ARRC's FAQ on this point.

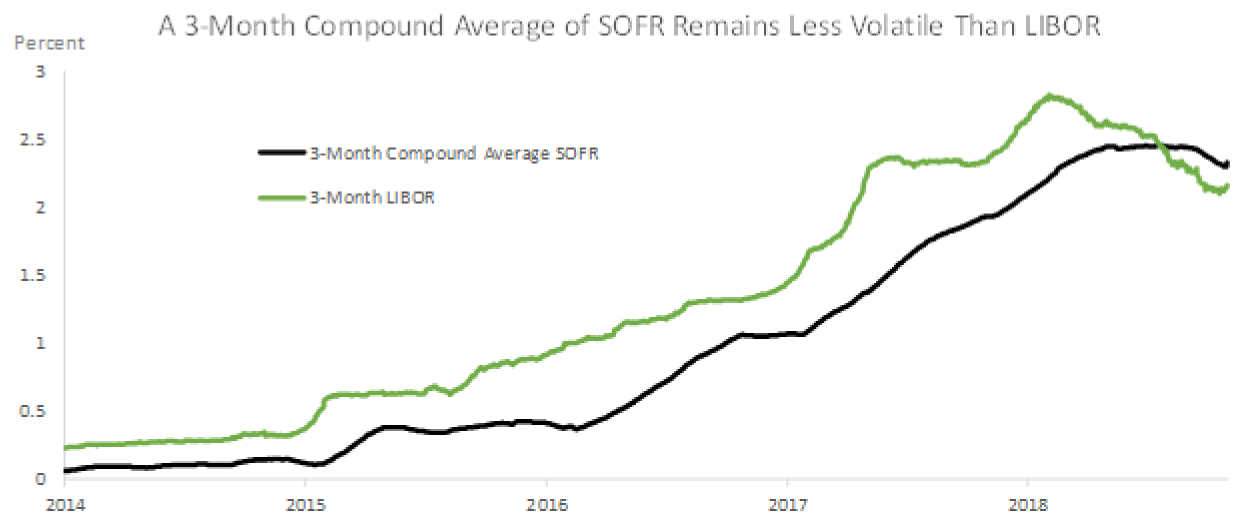
While it clearly is the cast that SOFR and other overnight repo rates are more volatile than term LIBOR rates on a day-to-day basis, it is important to remember that contracts referencing SOFR are based on averages of these daily rates. SOFR futures and OIS, and the many SOFR floating rate notes that have been issued all use either a compound or linear average of SOFR over a fixed period of time as the floating rate paid under the terms of the contract, not a single day's realization of SOFR.

These averages of SOFR are quite smooth and can be easily referenced in financial contracts, as demonstrated by the growing use of SOFR in futures, swaps, and floating-rate debt.

The ARRC's Second Report emphasized this point, showing that a 3-month average of overnight Treasury repo rates has historically been less volatile that 3-month U.S. dollar LIBOR over a wide range of market conditions (this was shown in Figure 5 of the ARRC's Second Report).

The charts below make clear that this remains the case, even given the volatility witnessed in repo markets this week and over year end. In the first chart, we show overnight SOFR along with 1-, 3- and 6-month averages of SOFR. The volatility in overnight SOFR is clearly visible, but it also can be seen to have had negligible impact on the averages of SOFR. The second chart clearly demonstrates that the point made in the ARRC's Second Report remains true: a 3-month average of SOFR is less volatile than 3-month LIBOR. For example, although SOFR rose sharply yesterday due to special factors related to tax payments and Treasury issuances, a 3-month average of SOFR only rose 2 basis points relative to the week before those fluctuations, while 3-month LIBOR rose 4 basis points.


Recent Movements in SOFR and Averaged SOFR
5.5
4.5
3.5
2.5
1.5
SOFR
1-Month Average SOFR
3-Month Average SOFR
6-Month Average SOFR
Sep-18
Nov-18
Jan-19
Mar-19
May-19
Jul-19
Sep-19


A 3-Month Compound Average of SOFR Remains Less Volatile Than LIBOR
Percent
3
2.5
2
1.5
1
0.5
0
3-Month Compound Average SOFR
3-Month LIBOR
2014
2015
2016
2017
2018