An Bradán Feasa SALMON SOFTWARE

LIBOR SONIA TRANSITION "DOESN'T NEED TO BE PAINFUL"

11 February 2019

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CEO and founder

John Byrne estabilished Salmon Software in 1985. One of the few remaining independent TMS Providers, the company pecialises in delivering affordable, world-class Treasury Management System software.

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Although firms have become wary of risks and significant costs as they begin to prepare for the transition from the London Interbank Offered Rate (Libor) to the Sterling Overnight Interbank Average Rate (Sonia) as the benchmark interest rate, the process of moving to the new rate doesn't have to be as strenuous as many believe. That's according to John Byrne, owner of Salmon Software.

Salmon Treasurer, the treasury management system built by Salmon has been recalibrated with new algorithms that will allow firms to make a quiet and easy transition.

"Following our update to the software, our clients will be able to migrate from one reference rate to the other but it's our job to make that as smooth as possible," says Byrne. "Our system changes make the process pretty straightforward for the clients. We have one or two that have already successfully completed it."

Libor has been used for several decades as the reference interest rate, and is currently in use on tens of millions of contracts worth more than $240trn globally – from vanilla to complex derivatives to residential mortgages, according to research by Oliver Wyman. But due to the 2008 Libor scandals, the Financial Stability Board (FSB) encouraged national and regional regulators to adopt risk free rather than interbank interest rates, which reflect bank credit risk. In the UK, following recommendations by the Bank of England (BoE), Sonia was put forward as the Libor alternative.

Although Sonia has been available from 1997, in April last year the BoE – which administers the interest rate – expanded the rate to include overnight unsecured transactions, and announced a volume-weighted trimmed mean method would be used for calculating the rate. Sonia will then appear on the business day after the day the rate related to, and will be published at 9am. As it's an average rate it shouldn't be easily manipulated.

Given how deeply entrenched Libor has become both in organisations' daily and longer-term risk and treasury planning, the recalibration has caused something of a stir among market participants. However, for those with TMS in their backend, the transition should be straightforward.

Byrne points out that the hard work has been carried out at Salmon, removing the complicated work clients would otherwise have to do around recalculating accruals – which against Sonia will have to be calculated against a multiplicity of rates - and complex recalibrations of trading exposures.

"Our clients are likely to have a series of loans and swaps that are currently tied to Libor, plus or minus a margin, and they're going to have to swap those out and link them to Sonia at some point in the future. We have to facilitate that in the system," says Byrne.

Many of the contracts in place currently run past the 2021 deadline, giving cause for concern that there will be a mixed bag of rates being used. However, Byrne is relaxed.

“Anyone with long term debt or interest rate swaps on their books are going to be stretching them way beyond 2021 - maybe ten to fifteen years beyond it,” he says. “So I don’t think it’ll be problematic in respect of the time, or when it has to be done, it’s the fact that it has to be done before that date and the fact that firms will have to ‘repoint’ their debt against Sonia within that timeframe. Once it’s done against one period it’s a fairly straightforward operation against subsequent periods.”

As 2021 approaches, a number of organisations have voiced concerns about their readiness – and banks and corporates alike have approached the huge amount of work involved in the transition with varying degrees of haste. For Byrne, however, the work has been completed in the Salmon TreasuRer application and firms can now make the transition easily.

“We have the capability to record all the rates that make up the Sonia average interest rate and we have a procedure in the system, and then it’s just a question of shifting off the reference from one table to another,” he says.

“The system will know what to do thereafter. Effectively it’s just a different way of calculating interest and a different way of calculating accruals. It’s just a new set of algorithms. Our clients will be able to make that transition within the system very smoothly.

With a number of corporates still relying on Excel, Byrne points out that Sonia’s complexities mean errors within their Excel models are more likely and great consideration needs to be given to ensure that thEse Excel models are accurate.

“Without a TMS, it will be really time consuming and will require a lot of checking and verification. It’s not a one size fits all, every loan is different. You could have a multiplicity of rates, and margins and so on. It’s tricky to do it manually.”