AMERIBOR® Term-30: A Case Study in the Robustness of a Credit-Sensitive Interest Rate Benchmark

August 30, 2021

Given the impending termination of LIBOR as a benchmark rate, market participants and regulators have been carefully evaluating how to replace LIBOR and its alternatives. Not surprisingly, different market participants have different needs. For example, some banks can fund at a risk-free rate while others while others borrow at credit-sensitive rates.

Over the past several years, a number of entities have developed alternative rates. The Alternative Reference Rates Committee (ARRC) developed the Secured Overnight Financing Rate (SOFR), which is published on a daily basis by the Federal Reserve Bank of New York (FRBNY) and reflects the cost of overnight borrowing and lending in the U.S. Treasury repo market.

The American Financial Exchange (AFX) was conceived of in 2011, initiated patent application in 2012 and published "Libor is Giving Derivatives a Bad Name" in September 2012. Since 2013, American Financial Exchange (AFX) has worked with regional and community banks to understand their needs. AFX incorporated in 2014 and began electronic trading in 2015. AFX is a self-regulated exchange, with 226 members across the 50 U.S. states. AFX offers a suite of innovative products to improve transparency and efficiency in the current interbank loans marketplace.

AFX also facilitates the determination of a market-based interest rate benchmark called the American Interbank Offered Rate (AMERIBOR®). AMERIBOR® is an interest rate benchmark that reflects the actual unsecured borrowing costs of more than 1,000 American banks and financial institutions. In addition, AFX's AMERIBOR® is in alignment with all nineteen IOSCO Principles.

In a written statement dated May 28, 2020 in response to a "question for the record" from Sen. Tom Cotton (R-AR) following Chairman Powell's testimony to the US Senate's Committee on Banking, Housing and Urban Affairs on February 12, 2020.

"Ameribor is a reference rate created by the American Financial Exchange ***based on a cohesive and well-defined market that meets the International Organization of Securities Commission's (IOSCO) principles for financial benchmarks***. [AMERIBOR] is a **fully appropriate rate** for the banks that fund themselves through the American Financial Exchange (AFX) or for other similar institutions for whom Ameribor may reflect their cost of funding."

While regulators recognize the need for a credit-sensitive rate, they have expressed concern that some of those credit-sensitive rates may be subject to manipulation that is similar to how the LIBOR scandal started. Their objections are legitimate; however, each benchmark needs to be evaluated based on its own construction methodology.

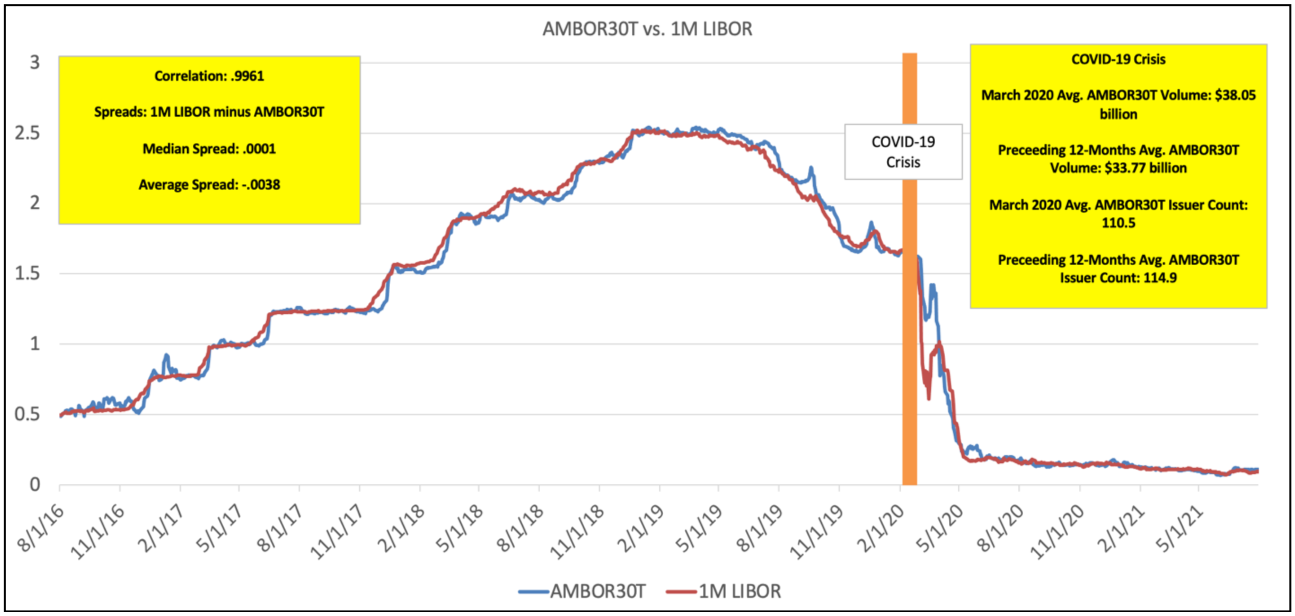
Two key misperceptions should be addressed:

1. The robustness of credit-sensitive rates; and
2. The breadth and depth of a market

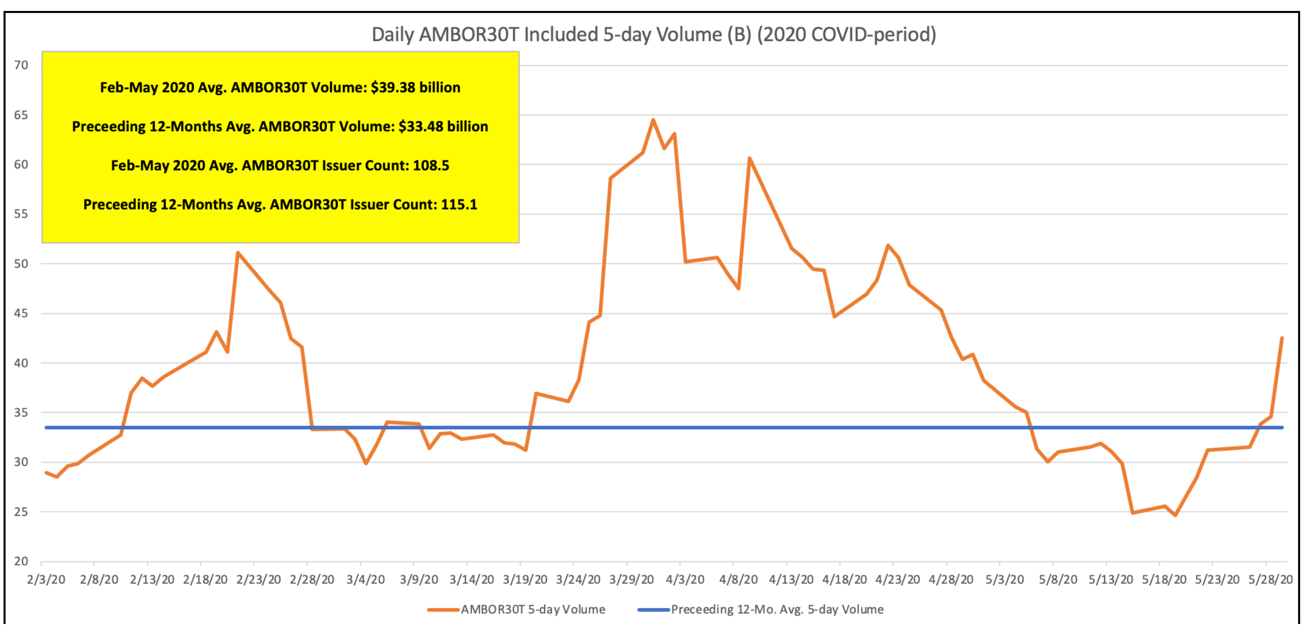
The purpose of this brief research note addresses the above. The note is divided into three sections: 1. A brief description of AMERIBOR® Term-30; 2. A brief discussion of the robustness of some credit-sensitive rates, and 3. A comparison of the breadth and depth of AMERIBOR® Term-30 to other major commodities, precious metals, and fixed-income markets.

INTRODUCTION

AMERIBOR® Term-30 (AMBOR30T), the entirely transaction-based one-month forward-looking term-rate complementing the AMERIBOR® overnight benchmark was introduced in early 2021. With a minimum included volume threshold of $25 billion dollars and including only real-world, cash-exchanged transactions from an average of 99.8 issuers per day over the course of 2020, it serves as a robust benchmark interest rate for financial market participants of all sizes. It captures the true breadth of the American financial system and accurately represents marginal funding costs at a certain moment in time for the majority of U.S. financial institutions.



Robustness: AMERIBOR® Term-30 was totally robust during the latest COVID-19-related crisis in early 2020. In fact, between February and May 2020 the average volume of included transactions actually rose 17.6% from the preceding 12-months average to $39.38 billion, sampling from an average of over 108 unique market participants per day.



Breadth vs. Depth: AMERIBOR® Term-30 compares favorably to other successfully traded food grains (wheat), precious metals (gold), and interest rates (US Treasury Bonds). Comparing the underlying volume of AMERIBOR® Term-30 to the annualized production statistics of well-established futures markets, there is evidence that the substantial breadth and depth of AMERIBOR® Term-30 is appropriate as a benchmark to create a liquid futures market to meet the needs of banks and financial institutions to hedge interest rate risk.

The below table compares annualized production or issuance, as well as the corresponding futures markets, across a variety of commodities and securities. The oldest U.S. futures market is wheat. It has served as a hedging mechanism and valuable price discovery tool since its establishment in 1867. Wheat futures serve as a benchmark for worldwide pricing.

Asset	Annual U.S. Production (2020)	Market Value of U.S. Production (2020)	Size of Futures Market (2020 Annual Notional)	Ratio of Futures Market to Annual Production Market
Wheat	1.884 billion bushels	$13.4 billion	$1.5 trillion	111.9%
Gold	200 metric tons	$12.0 billion	$13.3 trillion	1108.3%
30-Year Treasury Bonds	$299.1 billion in issuances in 2020	$229.1 billion	$14.8 trillion	64.6%
AMERIBOR® Term-30	47,583 unique loans across AMERIBOR® unsecured lending markets, CP, and CD.	$452.8 billion[1]	Trading commences Monday, September 13th, 2021.	N.A.

In summary, multiple benchmarks, as long as they are robust and representative of market activity, can serve different segments of the economy. Choice has worked well for other equity and commodities markets in the United States, the home of the world's most diverse, innovative and vibrant financial markets. Choice will work for interest rate benchmarks.

[1] Normalized to 30-day equivalent volume. Aggregate unadjusted included AMERIBOR® Term-30 loan volume equal to $1.7 trillion.