New Tradeweb/IBA benchmark tipped as 'competitor' to SOFR

Forward-looking risk-free rate aimed at US mortgage market could have broader applications. By **Robert Mackenzie-Smith**

A new benchmark developed jointly by Tradeweb and Ice Benchmark Administration is being eyed as a potential alternative to the secured overnight financing rate (SOFR), the Federal Reserve's preferred alternative to US dollar Libor.

The constant maturity Treasury (CMT) rate tracks the volume-weighted average price of on-the-run US Treasury bills, notes and bonds executed on Tradeweb's dealer-to-client platform.

Colm Murtagh, head of US institutional rates at Tradeweb, says the CMT rate will be a "complement" to SOFR and is aimed at the mortgage market. "Mortgage originators use a constant maturity Treasury rate," he says. "We would be targeting that [sector]."

Others see it as a direct competitor. "It seems to make more sense as a competitor to SOFR," says Mark Brell, executive vice-president of global trade services at Texas-based Frost Bank. "You can make the argument that the market is deep and liquid, so it's understandable why people are throwing that idea around."

Brell is a participant in the credit sensitivity group convened by US regulators to find ways to make SOFR more palatable to lenders.

A report published by Tradeweb and IBA in July also suggests the CMT rate could have wider applications. It could be used as a benchmark for cash products, such as floating rate notes and loans, the companies say – making it an alternative to SOFR in those markets. The CMT rate could also be used as a benchmark for floating rate preferred stock, a market estimated to be close to $250 billion in size.

The CMT rate's natural term structure might also appeal to investors that want a forward-looking benchmark. A term version of SOFR could be released before the end of this year, at least in trial form, though a final version is not expected to be available until the first half of 2021, at the earliest.

"Asset managers who currently manage short-duration money against a Libor index would probably want to see some sort of risk-free rate in the three-month or six-month term that they could actually use to manage money against," says Murtagh.

"The move from Libor is not one size fits all," he adds. "There's many different options and, depending on the financial instrument you're talking about, maybe there is a better benchmark."

The CMT rate will be available in 12 maturities from one month to 30 years.

While the CMT rate is inherently forward-looking, given the term structure of the US government securities it tracks, it has some of the same drawbacks as other risk-free rates. Like SOFR, it lacks a bank-sensitive credit component, which is seen as crucial for lending.

"CMT based indices have the same basic problems in terms of a lack of credit sensitivity that SOFR does, so that wouldn't be at the top of our list as far as something we'd be looking to use as a replacement index for Libor," says a treasurer at one US regional bank.

Moving mortgages

The inclusion of Tradeweb data takes the Ice swap rate into new territory. In contrast to fully firm and actionable Clob prices, executable dealer-to-client swap quotes streamed on the platform are subject to last look, and therefore negotiable.

In the US mortgage market, the transition away from Libor is already under way. Fannie Mae and Freddie Mac, the government-sponsored enterprises (GSEs) that acquire most US mortgages, will cease purchases and issuances of Libor-based adjustable-rate mortgages (ARMs) and mortgage-backed securities (MBSs) respectively by the end of this year. The GSEs have been able to purchase single-family ARMs and issue MBSs linked to SOFR since August 3.

ARMs accounted for 3.5% of mortgage originations in June, according to a recent report from mortgage software company Ellie Mae.

The US Treasury already produces a

CMT rate that can be used as a benchmark for ARMs, in place of US dollar Libor.

The US Treasury's CMT rate is based on an end-of-day snapshot of indicative quotes obtained by the Federal Reserve Bank of New York. Tradeweb and IBA are using data taken from Tradeweb's dealer-to-client trading platform over the course of the day. Murtagh says this approach aligns more closely with the principles for financial benchmarks developed by the International Organization of Securities Commissions in 2013.

"It would be much more representative to have volume-weighted average prices on transactions actually entered into between institutional clients and dealers, because that's a much more reflective rate of where trades are actually happening," he says.

Average daily volume of US Treasury transactions on Tradeweb's platform totalled $83.7 billion in July.

The GSEs can purchase ARMs linked to the Treasury's CMT rate, though it is unclear if they will be able to acquire mortgages referencing Tradeweb and IBA's new rate. The Federal Housing Finance Agency, which regulates the GSEs, declined to comment.

The emergence of the new CMT rate adds another twist to the already tangled US dollar Libor transition. While regulators want the market to use SOFR wherever possible, a number of other benchmarks – such as Ameribor and the Ice Bank Yield Index – are targeting various slices of the market.

The credit sensitivity group convened by US regulators is also attempting to create a credit index that can be layered on top of risk-free rates to make them more suitable for cash products.

"The real question is who's going to pick what and who's going to start using these rates," says Adam Schneider, partner at Oliver Wyman's digital and banking practices in the Americas. "All of these [benchmarks] exist, or could exist tomorrow. It's a market question. What's going to be the market favourite?"

Tradeweb and the IBA are currently consulting the market on the methodology for the CMT rate. The companies declined to say when the rate will begin publishing. ■