Thursday, December 06, 2018 4:21 PM ET

SEC chairman calls Libor transition a key risk for 2019

By Declan Harty

Wall Street's chief regulator has named the impending transition away from the London interbank offered rate a key risk for industry participants heading into 2019.

At the end of 2021, banks are expected to stop reporting the data used to create the benchmark reference rate also known as Libor. With an estimated $200 trillion in notional transactions tied to Libor, the move to a new benchmark rate known as the Secured Overnight Financing Rate, or SOFR, will impact the future of everything from corporate debt to interest-rate swaps, SEC Chairman Jay Clayton said.

"A significant risk for many market participants — whether public companies who have floating-rate obligations tied to Libor, or broker/dealers, investment companies or investment advisers that have exposure to Libor — is how to manage the transition from Libor to a new rate such as SOFR," Clayton said during a Dec. 6 speech.

The 2021 transition away from Libor will come nearly a decade after a plot to rig the benchmark rate was unearthed. In the scandal's aftermath, several alternatives to Libor were proposed, including SOFR, which measures the cost of borrowing cash overnight collateralized by Treasury securities.

Still, questions linger around how industry participants will switch from one benchmark rate to another. Clayton said he is specifically concerned about the existing contracts based on Libor that will still be outstanding at the end of 2021. Those contracts are estimated to total around $35 trillion, according to the Alternative Reference Rates Committee, a group convened by the Federal Reserve to identify alternative rates.

The SEC, the Fed and other regulators are monitoring the risks that could come from those contracts.

"We have started to see more SOFR-based debt issuances, and we have seen promising developments in the SOFR swaps and futures markets," Clayton said. "But I want to make sure that market participants are aware of the need to plan for this important transition, as a lot of the work will fall on them."

The SEC chief named cybersecurity and the U.K. leaving the EU as two other key risks that the agency is monitoring ahead of 2019.

While the specific impacts of Brexit remain unknown, Clayton said companies need to be providing "more robust disclosures" about how they are considering Brexit. He added that he is concerned that "the potential adverse effects of Brexit are not well understood and, in the areas where they are understood, are underestimated."