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MARKETS

Futures Guru Targets Libor Replacement

Richard Sandor, known for creating futures markets in the 1970s, has a new Libor alternative that is gaining traction

By Daniel Kruger

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A leading figure behind the creation of futures markets in the 1970s is joining the race to replace the benchmark interest-rate underpinning trillions of dollars worth of financial contracts world-wide.

Richard Sandor, who was instrumental in creating interest-rate futures in the 1970s and greenhouse-gas emissions trading in the 1990s, has launched his own version of the scandal-tainted London interbank offered rate, or Libor. His benchmark, known as Ameribor, would be based on rates set on his American Financial Exchange, where banks lend to each other through mutual lines of credit.

While Wall Street banks and regulators spent three years discussing their options before deciding on their preferred Libor replacement—the secured overnight financing rate, or SOFR—Mr. Sandor was on the road, meeting with small banks, signing them up to his exchange. The exchange earns money on transaction fees, and expects one day to license Ameribor and sell data generated by its transactions.

"It's a very entrepreneurial and smart idea," said Darrell Duffie, a finance professor at Stanford University. While SOFR has the backing of the Federal Reserve Bank of New York and is supported by big banks, many smaller firms and investors want "a floating-rate index like Libor that's sensitive to bank funding costs," he said.

Finding the best benchmark to replace Libor for variable-rate lending is crucial challenge for banks, because a mismatch between what they pay on deposits and charge on loans could affect their profits and the affordability of loans for their customers, both businesses and individuals.

Mr. Sandor began examining the potential for a new reference rate in 2011, three years before the Fed's alternative reference rates committee. That came after authorities jailed several traders and fined banks billions of dollars following evidence that traders were manipulating Libor. Regulators eventually decided to phase out the rate and set 2021 for its expiration.

At first, Mr. Sandor encountered skepticism among bigger banks, which have access to cash from large branch networks and the market for so-called repurchase agreements, where they can raise money by lending securities overnight. Smaller banks, however, viewed Mr. Sandor's network as an inexpensive, reliable source of funds.

Mr. Sandor has been recognized for his financial innovations. PHOTO: LYNDON FRENCH FOR THE WALL STREET JOURNAL

"The value proposition was not for the 10 to 20 big banks, it would be for regional and community banks," he said.

So far Mr. Sandor has signed on close to 700 out of roughly 5,300 U.S. regional and community banks to the AFX network. That puts him about two-thirds of the way to his goal of connecting with 20% of those banks.

Those banks lent each other an average of roughly $1.5 billion a day in this year's first quarter. While that pales in comparison with activity in SOFR, where the value of futures and options contracts hit a record $479 billion on the CME last month, AFX lending provides enough data to compute an Ameribor benchmark.

Mr. Sandor has a history of financial innovation beginning in the 1970s when, as chief economist at the Chicago Board of Trade, he developed the first interest-rate futures contract. A believer in market-based solutions to policy problems, he began working in the 1990s on a way to buy and sell carbon emissions. He has also taught in graduate programs at schools including Northwestern and the University of Chicago.

The climate project led to a big payday in 2010 when Mr. Sandor sold his Climate Exchange PLC—the London-listed operator of the European Climate Exchange and the Chicago Climate Exchange—to Intercontinental for $597 million. The year after, he turned his attention to developing a market for water rights in parts of the U.S. and Canada, but switched his focus after becoming fixated on the turmoil surrounding Libor.

Mr. Sandor's understanding of markets has made Ameribor appealing for small banks, said Tom Broughton, the chief executive officer at Birmingham, Ala.-based ServisFirst Bank. ServisFirst has been borrowing through AFX credit lines for two years and was the first bank to use the benchmark in a loan to a car dealership, Mr. Broughton said.

Ameribor reflects bank borrowing costs better than SOFR and hasn't been prone to quarter-end volatility the way the Fed's gauge has, he said. SOFR seems far removed from Mr. Broughton's business and Mr. Sandor has developed a "deep and close relationship," Mr. Broughton said. "We have confidence [Ameribor] is going to be fine. If there's a problem, we'll fix it."

Mr. Sandor, 77 years old, often sports a fedora and speaks in measured cadences often more associated with Minnesota, where he went to graduate school, rather than Brooklyn, where he grew up. That down-home demeanor seems to have helped as he has visited Kansas, Wisconsin and other places off the beaten path for most Wall Street bankers.

Mike Rechin, chief executive officer of First Merchants Bank in Muncie, Ind., which has $2.4 billion of loans to clients that have rates that are pegged to Libor, prefers Ameribor to SOFR in part because of Mr. Sandor's personal approach.

"We don't have a relationship" with the committee that designed SOFR "like we do with

Mr. Sandor, who is teaching at the University of Chicago, gives a speech at the Kellogg Global Hub on the Evanston campus of Northwestern University. PHOTO: LYNDON FRENCH FOR THE WALL STREET JOURNAL

Ameribor," Mr. Rechin said.

Ameribor is gaining in market awareness. Wells Fargo's chief Libor transition officer, Brian Grabenstein, said he has been asked whether it might be a more suitable reference rate for clients than the Fed's SOFR benchmark. While Mr. Grabenstein acknowledges Ameribor may be useful, he emphasizes that the Fed and the regulatory community are endorsing SOFR as Libor's successor.

Fed officials declined to comment.

Mr. Sandor has a sense of the opportunity and the work still ahead. While the AFX is trying to gain traction without the endorsement of Wall Street and its regulators, it is helped that his clients appear to have little need for those things.

"It takes 10 to 15 years to build a market," Mr. Sandor said. "It's not like you're in Silicon Valley and all of a sudden it changes the world."

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