Updates to the SOFR Calculation Methodology in the DVP Segment

December 2, 2024

As of November 25, 2024, the Federal Reserve Bank of New York ("New York Fed"), as administrator of the Secured Overnight Financing Rate ("SOFR"), began publishing SOFR using a modified SOFR calculation methodology. The modifications to the SOFR calculations pertain to affiliated institutions and "specials" transactions within the centrally cleared Delivery-versus-Payment ("DVP") segment of the repo market, which is the largest of the three market segments incorporated into the daily calculation of SOFR. The modifications will not alter SOFR publications prior to November 25, 2024. Additionally, the modified SOFR calculation methodology has been applied to historical data and does not result in notable changes in transaction volumes or rates.

The first modification removes transactions between affiliated institutions. Prior to the modification, the New York Fed removed transactions when relevant and when the data was available. After the modification, the New York Fed will use data necessary to assess affiliation in the centrally cleared DVP segment from the U.S. Department of the Treasury's Office of Financial Research's collection of centrally cleared repo transactions to produce SOFR. The New York Fed will review the data to assess whether there are any transactions that should be excluded from the rate calculations for a given day, such as those that appear not to have been conducted at arm's length. If neither of the affiliated institutions appear to be acting in a fiduciary capacity, then transactions will be excluded on a "best efforts" basis.

The second modification adjusts the mechanism applied to mitigate the influence of "specials" transactions on the measurement of the general cost of financing. In the DVP repo market, counterparties identify specific securities to settle each trade, and, as a result, the DVP repo market can be used to temporarily acquire specific securities. "Specials" transactions occur when repos for specific-issue collateral are executed at rates below those for general collateral repos if cash providers are willing to accept a lesser return on their cash to obtain a particular security. In order to eliminate the day-to-day variability in the share of centrally cleared DVP activity, the New York Fed will now remove a consistent 20% of the lowest-rate transaction volume from the DVP segment each day. In order to ensure that 20% of the DVP volume is removed, a pro rata calculation will be applied to the volume of each transaction occurring at the 20th volume-weighted percentile rate after removing the transactions between affiliated institutions.

The modifications to underlying mechanics of SOFR calculation in the DVP segment of the repo market is important to ensure that SOFR continues to reflect its underlying interest and that SOFR remains a robust benchmark. Notably, the implementation of the modified SOFR calculation methodology should come with no significant changes overall to the rates and volumes.

We will continue to monitor any further updates and report accordingly.

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