



# The Shift From Eurodollar To SOFR Is Accelerating

Oct. 30, 2021 1:10 AM ET | TBT, TLT, TMV... | 2 Likes



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## Summary

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CME Group launched SOFR-based futures in 2018 to support the transition, and they have proven to be one of CME's most successful ever product launches.

Over 600 customers have traded SOFR futures to date, and activity levels in 2021 year-to-date are 200% higher than the same period in 2020.



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*Originally published on October 19, 2021*

*By Owain Johnson and Mark Rogerson*

## At a Glance

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The pace of transition in futures and options markets has sped up with total SOFR exposure beyond 2023 rising quickly.

The pace of the transition to the new U.S. interest rate benchmark, [the Secured Overnight Financing Rate \(SOFR\)](#), has picked up dramatically in recent months, with additional impetus coming from July's successful launch of the 'SOFR First' initiative by U.S. regulator the Commodity Futures Trading Commission (CFTC).

SOFR measures the cost of borrowing U.S. dollar cash overnight using Treasury securities as collateral. SOFR has been recommended by the U.S. Federal Reserve's Alternative Reference Rate Committee (ARRC) and SOFR looks set to become the main indicator of USD interest rates around the world as global regulators encourage market participants to transition to SOFR ahead of the scheduled [discontinuation](#) of publication of a "representative" USD LIBOR rate after June 30, 2023.

CME Group launched SOFR-based futures in 2018 to support the transition, and they have proven to be one of CME's most successful ever product launches. Over 600 customers have traded SOFR futures to date, and activity levels in 2021 year-to-date are 200% higher than the same period in 2020.

SOFR futures are growing fast, but the products are clearly still in their infancy, at least relative to Three-Month Eurodollar futures, which have been trading for almost 40 years. Recently, though, the balance of USD rates futures and options exposure has begun to swing in favor of SOFR.

This is partly the result of the [announcement earlier this year](#) that any Eurodollar exposure where the start date is beyond June 30, 2023, will automatically convert to the corresponding CME SOFR futures plus a fixed spread of 26.161 basis points (based on the ISDA spread adjustment methodology agreed as part of global industry consultation).

## **SOFR, So Good**

This defined conversion process and fixed spread means that any market participant trading a Eurodollar futures contract that expires after June 2023 effectively has exposure to the corresponding SOFR futures contract plus a spread of 26.161 basis points.

This fixed relationship between CME Eurodollar and CME SOFR futures appears to be well understood by the broader market. The spread between [3-month SOFR futures](#) and Eurodollar futures for the months beyond June 2023 confirms that the link is firmly embedded in market pricing.

Beyond June 2023, SOFR-Eurodollar spreads are trading in a very tight 26-26.5 basis point range, which closely reflects the fixed fallback conversion spread of 26.161 basis points.

Before June 2023, the spread behaves very differently and the relationship between SOFR and Eurodollar futures is much more dynamic.

3-MONTH SOFR/EURODOLLAR FUTURE SPREAD 1:1 (SR3/GE)					
PRODUCT	DESCRIPTION	QTY	BID	ASK	QTY
SR3/GE	+1 SR3 Mar23, -1 GE Mar23	491	15.0	15.5	1961
SR3/GE	+1 SR3 Jun23, -1 GE Jun23	2411	16.0	16.5	291
SR3/GE	+1 SR3 Sep23, -1 GE Sep23	1565	26.0	26.5	9536
SR3/GE	+1 SR3 Dec23, -1 GE Dec23	4310	26.0	26.5	12412
SR3/GE	+1 SR3 Mar24, -1 GE Mar24	1788	26.0	26.5	4840

## A Rush and A Push

At first glance, SOFR exposure in futures and options might appear limited.

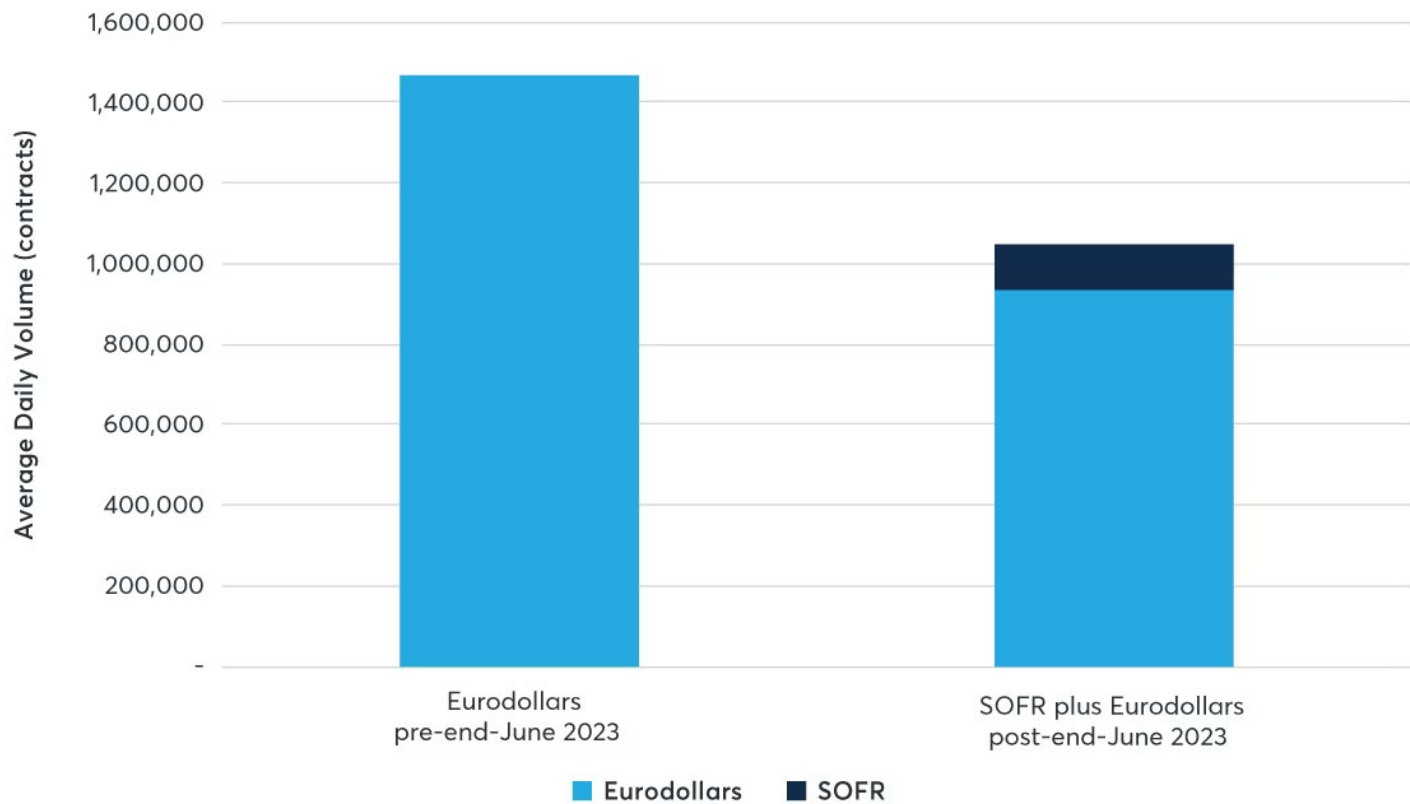
But given that Eurodollar futures beyond June 2023 are effectively linked to the corresponding SOFR futures for the reasons outlined above, the picture in terms of effective benchmark exposure looks very different.

Over 46% of the total current ED futures OI is tied to post-June 23 LIBOR, which is now truly SOFR-based risk; in other words, ED+SOFR expirations, which will convert to SOFR positions if held until a LIBOR cessation event. SOFR-linked OI of 20.2M contracts is up 70% vs. March, when SOFR-based fallbacks were introduced to the CME Rulebook.

The progress of benchmark transition is even further advanced in the options market, where CME has announced a similar conversion methodology which will convert options on Eurodollar futures into options on corresponding SOFR futures at the same time as the scheduled Eurodollar futures conversion.

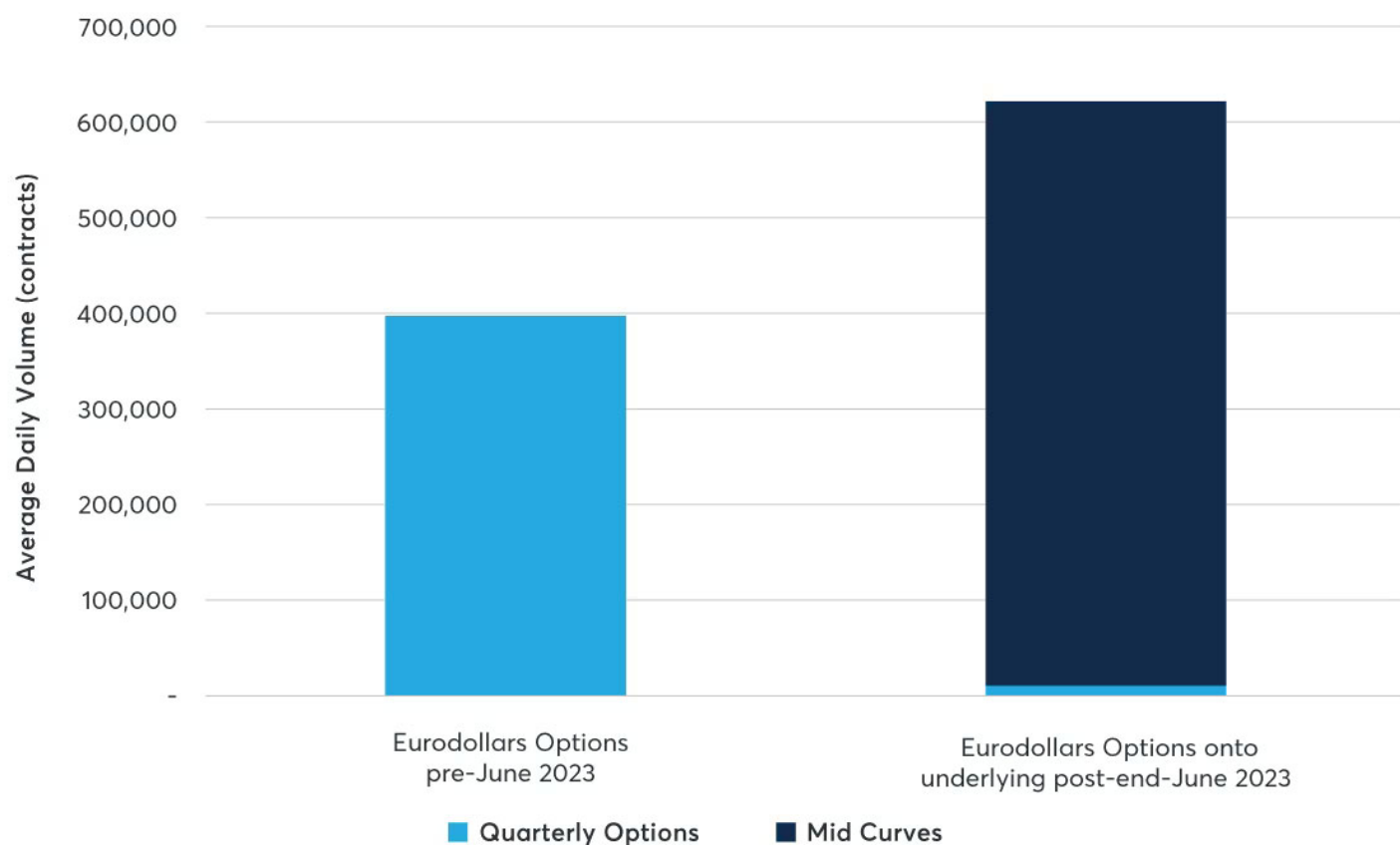
When we add together the volume of SOFR options, Eurodollar options that expire beyond June 2023, and earlier Eurodollar options that expire into later underlying futures contracts, we can see that an impressive 61% of relevant options are already trading with underlying risk tied directly to or linked to SOFR.

### Comparison of Futures ADV pre and post June 2023





## Eurodollar Options ADV



### Onwards and Upwards

The futures and options markets have in large part accepted the transition to SOFR and the spreads in the markets recognize the fixed relationship between CME Eurodollar futures and options and SOFR futures and options for expiries beyond June 2023.

The increased adoption of SOFR in the over-the-counter (OTC) markets in recent months - SOFR [trading increased 78% in August](#), according to one measure - may have surprised some observers, but the pace of transition has been even faster in the futures and options markets.

That's because SOFR futures and the SOFR-linked Eurodollar market is expected to provide liquidity for fast growing needs in the marketplace. If market participants are ready to make SOFR futures part of their risk management strategy, the stable 26 basis points relationship and the massive Eurodollar futures liquidity will absorb bigger positions in SOFR futures.

The success of the transition to SOFR in the futures and options markets shows how comfortable the market has become with SOFR and is a powerful indicator of still greater take up of the new benchmark in the OTC markets.

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**Editor's Note:** The summary bullets for this article were chosen by Seeking Alpha editors.

This article was written by



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