

LIBOR: The end of an era....a time for change

4 August 2021 5 min read

London Interbank Offered Rate (“LIBOR”)

Over the last couple of years, there has been talk in the banking and finance sector of the announcement by the UK’s Financial Conduct Authority (“**FCA**”), that the London Interbank Offered Rate (“**LIBOR**”), will cease to exist on 31 December 2021, less than six months from now, with the cessation of several USD LIBOR settings being delayed to 30 June 2023. From these dates onwards, the FCA will no longer require banks to submit rates for LIBOR, which is the manner in which LIBOR has been determined over the years.

The Greek philosopher, Heraclitus famously said: “change is the only constant in life”.

Following the 2008 financial crisis, regulators found that the method of determining LIBOR historically was manipulated because there were very few transactions which took place which supported the currencies and tenors for which LIBOR was published. Submissions by banks of rates for purposes of determining LIBOR, were based upon banks falsely inflating or deflating their rates so as to gain profits and/or limit losses or to give the impression that they were more creditworthy than they actually were, instead of being based upon actual transaction data. In addition, banks were estimating the rate that they would hypothetically lend to one another instead of determining the rate on real transactions in the market.

It is clear that given its approximately 50 year history, the cessation of LIBOR will have a significant effect in the banking and finance sector.

Impending demise of LIBOR

In light of the impending demise of LIBOR, regulators in various jurisdictions globally, have been working on suitable rates to replace it. The result has been to use backward looking overnight rates or new risk free rates, which are based on actual transactions as a more accurate means of measuring the cost of borrowing money, which is not easily subjected to manipulation.

Last week, the US benchmark reform panel (the Alternative Reference Rates Committee), endorsed the new term rate known as SOFR (the Secured Overnight Finance Rate) as a suitable alternative to USD LIBOR. This decision has marked a decisive step forward in the race to replace LIBOR given its imminent demise. In addition, alternative rates for each of the following LIBOR currencies have been identified in the various applicable jurisdictions as the most appropriate risk free rates to replace LIBOR: the Sterling Overnight Index Average (SONIA) for GBP; the Euro Short Term Rate (ESTR) for Euro; the Swiss Average Rate Overnight (SARON) for Swiss franc; and the Tokyo Overnight Average Rate (TONA) for the Japanese Yen.

Financial Stability Board (“FSB”) recommendations

According to the Financial Stability Board (“**FSB**”), an international body that monitors and makes recommendations about the global financial system, for a smooth and orderly transition from LIBOR requires, at a minimum, steps to stop issuance of new products linked to LIBOR and efforts to transition away from LIBOR in legacy contracts wherever feasible. The latter has to be the biggest challenge.

Proactive steps have been suggested by various regulators and working groups to mitigate transition risks, although none have been legally mandated or endorsed. The FSB has recommended the following steps to transition away from LIBOR in legacy contracts:

- identify and assess all existing LIBOR exposures and what fallback arrangements those agreements currently have in place;
- implement a plan for communicating with end-users of LIBOR referencing products maturing beyond the end of 2021 to ensure they are aware of the transition and the steps being taken to support moving those products to alternative rates;
- lenders should be in a position to offer non-LIBOR linked loan products to their clients. This could be done either in terms of giving borrowers a choice in terms of the reference rate underlying their loans, or through working with borrowers to amend existing agreements to include language for conversion ahead of cessation dates for any LIBOR referencing loans; and
- for any LIBOR legacy agreements for which it is not possible to make the proposed amendments, the implications of cessation of LIBOR should be considered and discussed between the parties, and steps should be taken to prepare for this outcome as needed. This would require skillful negotiation where a party refuses to amend a legacy agreement.

In South Africa,

- some financial institutions have started to take the necessary steps to deal with the cessation of LIBOR in relation to their products and it remains to be seen if all lenders will be prepared for the end of LIBOR and the change it brings; and
- given the reasons for and following the decision to cease the use of LIBOR, the South African Reserve Bank has confirmed that the Johannesburg Interbank Bank Average Rate (JIBAR), will cease ‘at some future point’ and that South Africa would transition to alternative reference rates. No fixed date has been set for the cessation of JIBAR although there has been some indication that this would be in 2024, with the replacement reference rate most likely being the South African Rand Overnight Index Average (**ZARONIA**), which is an unsecured overnight rate. In such circumstances, it would be prudent for the recommendations by the FSB in relation to the steps to be taken for the cessation of LIBOR to similarly apply in relation to the cessation of JIBAR.

AFRICRYPT – yet another South African crypto asset scam. [Read more.](#)

by Aarthi Ramdhin, Director



Aarthi Ramdhin

Director

[View Profile](#)