

Cessation of LIBOR: complete transition

Background

The London Inter-Bank Offered Rate, ('LIBOR'), has been the reference rate for financial markets globally for many decades. It is the benchmark interest rate at which global banks lend to one another. Lenders, i.e., banks and other financial institutions used LIBOR as the benchmark for determining interest rates for various debt instruments.

Due to the revelations that LIBOR was manipulated by individuals at various financial institutions, its credibility was under threat and hence the Financial Conduct Authority ('FCA'), in 2017 decided to discontinue its power to mandate banks to poll LIBOR beyond end-2021.

Hence, banks and financial institutions worldwide have started transitioning from the age-old LIBOR to the new alternative reference rates (ARR). Till the time a complete transition is achieved, there will be inherent exposure risk and financial institutions need to measure it to determine the impact on their financial statements.

Complete transition

With effect from 1 July 2023 LIBOR will cease to be used in India. In this regard, the RBI has issued an advisory to banks and other RBI-regulated entities, emphasizing the need to take steps to ensure a complete transition away from the LIBOR.

RBI will continue to monitor the efforts of banks/FIs for ensuring a smooth transition from LIBOR.

RBI's roadmap for LIBOR transition

Pursuant to the FCA announcement that LIBOR will 'either cease to be provided by any administrator or no longer be a representative rate,' RBI (in July 2021) issued LIBOR transition roadmap to discontinue the LIBOR reference rate. The roadmap advised the banks and financial institutions:

- a. to use an alternative reference rate (ARR), e.g., daily adjusted MIFOR and modified MIFOR. (Mumbai Interbank Forward Outright Rate). These rates are being published since June 2021.
- b. to undertake a comprehensive review of all direct and indirect LIBOR exposures and put in place a framework to mitigate risks arising from such exposures on account of transitional issues including valuation and contractual clauses.

ICAI's LIBOR transition – valuation guide

In February 2022, the Institute of Chartered Accountants of India ('ICAI') published a valuation guide to various stakeholders educating them about the preparedness they need to have till the time a full transition is achieved.

Weblink

<https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/PR22160F72985100342E8B10C9C683CF56E1E.PDF>

Therefore

The discontinuation of LIBOR in many global jurisdictions is a significant historic event. Banks and financial institutions worldwide will now have to refer to ARR while entering into new contracts. Legacy contracts in India (i.e. those entered in before 31 December 2021 but maturing before 30 June 2023) need to be based on 'adjusted MIFOR' while the new contracts will be based on modified MIFOR.