

Corpsec Hotline

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LIBOR(ED): TIME TO SET NEW BENCHMARKS!

LIBOR DISCONTINUATION

London Interbank Offer Rate ("LIBOR") was one of the most popular benchmark rates linked with interest rates across the globe. Often the loan products with variable interest rates were linked to LIBOR to determine the final interest rate. However, due to multiple allegations and manipulations surrounding it¹, the Financial Conduct Authority ("FCA"), UK, in a press statement dated March 05, 2021² announced that all London Interbank Offer Rate ("LIBOR") settings will either cease to be provided by any administrator or no longer be representative of (i) all Pound Sterling, Euro, Swiss Franc, and Japanese Yen settings, and the 1-week and 2-month US dollar settings after December 31, 2021; and (ii) in the case of overnight, 1-month, 3-month, 6-month, and 12-month maturities will cease immediately after June 2023. Pursuant to the aforesaid press release by FCA, the Reserve Bank of India ("RBI") had issued multiple advisories and notifications³ for the transition from LIBOR to any other widely accepted Alternative Reference Rate ("ARR").

NEW BENCHMARK

On December 08, 2021, RBI notified the External Commercial Borrowings (ECB) and Trade Credits (TC) Policy – Changes due to LIBOR transition ("ECB LIBOR Notification").⁴ Accordingly, the Master Direction on External Commercial Borrowings, Trade Credits and Structured Obligations as updated on December 10, 2021, reflects the following changes notified under the ECB Notification:

- Redefining Benchmark Rate for foreign currency ("FCY") ECBs and Trade Credits ("TC")s:** Prior to the ECB LIBOR Notification, the benchmark rate pertaining to FCY ECB/TC was pegged to 6-months LIBOR rate of different currencies or any other 6-month interbank interest rate applicable to the currency of borrowing. Now, the same has been updated to "any widely accepted interbank rate or alternative reference rate (ARR) of 6-month tenor, applicable to the currency of borrowing."
- Change in all-in-cost ceiling for new ECBs/ TCs:** As there would be differences in the credit risk and term premia for the loans pegged to LIBOR in comparison with the ARRs, the RBI has tried to balance it out by increasing the per annum all-in-cost ceiling for new FCY ECBs and TCs by 50 bps to 500 bps and 300 bps, respectively, over the benchmark rates.
- One Time Adjustment in all-in-cost ceiling for existing ECBs/ TCs:** For similar reasons as stated in (ii) above, the RBI has increased the per annum all-in-cost ceiling for the existing FCY ECBs and TCs by 100 bps to 550 bps and 350 bps, respectively, over the benchmark rates. However, an obligation has been cast on the AD Category-I banks to ensure that any such revision in the ceiling of existing FCY ECBs/TC is only on account of the transition from LIBOR to ARR.

Further, there has been no change in the all-in-cost benchmark or the ceiling for INR ECBs/ TCs and the same continues to be at 450 basis points above the benchmark rate.

RESPONSE BY THE MARKET PLAYERS

Most financial institutions have already started phasing out LIBOR and substituting with alternate benchmarks much before December 31, 2021 deadline. There are several ARR benchmarks, however, till date, none of them have been as widely used as LIBOR. Some of the market leaders are now pegging their interest rates to Secured Overnight Financing Rate ("SOFR") and Sterling Overnight Interbank Average Rate ("SONIA").⁵

IMPACT ON THE FCY ECBs

The way forward for the fresh ECB contracts executed by the financial institution is comparatively simpler, as they will be negotiating the interest rates based on the new ARR, from the very beginning. Whereas existing FCY ECB contracts executed prior to December 31, 2021, pegged to LIBOR and which mature after December 31, 2021, have to be amended by the relevant parties to incorporate the ARR instead of LIBOR.

CONCLUSION

The RBI has taken a very proactive approach by notifying the stakeholders almost 2 (two) years before transitioning from LIBOR thereby providing adequate time to put in place appropriate systems and mechanisms to address this change. There may be some issues that the parties may have to face in terms of adjusting to the new ARR, calculation of interests, reaching out to all the relevant parties for the execution of amendment agreements, etc.

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However, given the history of LIBOR, systems being in place, and the stance of the stakeholders, the market for ECBs may turn out to be better off without LIBOR.

– Akash Kumar, Harshita Srivastava & Nishchal Joshipura

You can direct your queries or comments to the authors

¹ The State Bank of India, LIBOR TRANSITION COMPENDIUM, available at https://www.sbi.co.in/documents/16337/16538/241221-SBI-LIBOR_Transition_Compendium_-_Booklet_Digital+-Ver+3-Dec+2021.pdf

² FCA announcement on future cessation and loss of representativeness of the LIBOR benchmarks, dated March 5, 2021, available at <https://www.fca.org.uk/publication/documents/future-cessation-loss-representativeness-libor-benchmarks.pdf>

³ RBI Press Release, Cessation of LIBOR: Transition arrangements, dated July 08, 2021; RBI Notification on Use of any Alternative reference rate in place of LIBOR for interest payable in respect of export / import transactions, dated September 28, 2021.

⁴ RBI Notification, External Commercial Borrowings (ECB) and Trade Credits (TC) Policy – Changes due to LIBOR transition, notification no. RBI/2021-22/135 A.P. (DIR Series) Circular No. 19, dated December 08, 2021.

⁵ SBI adopts new benchmark rate, drops decades old Libor, available at: http://timesofindia.indiatimes.com/articleshow/8100%0262.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst;

LIBOR set to go and SOFR to replace it as new benchmark: Five questions answered, available at <https://www.moneycontrol.com/news/business/economy/libor-set-to-go-and-sofr-to-replace-it-as-new-benchmark-five-questions-answered-6624851.html>

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