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FSB says alternatives to Libor benchmark are showing a "great deal of progress"

By Jon Rees

Moves to develop alternatives to the London interbank offered rate, the interest rate benchmark that was at the center of a worldwide rate fixing scandal, are progressing well, according to the Financial Stability Board.

The move from interbank offered rates as benchmarks to new, so-called overnight risk-free rates, which provide the theoretical rate of return on an investment with zero risk, has been compared to the move to a single currency in Europe, by the International Swaps and Derivatives Association, or Isda, a trade body.

Regulators have repeatedly warned market participants to prepare for the end of Libor, which underpins financial transactions across the globe, in 2021 by which time a market-based alternative is expected to have replaced it. Libor measures the cost of unsecured borrowing between banks for a specific period. Isda said more than $370 trillion of deals are tied to interbank offered rates, while $170 trillion depend on Libor.

The FSB, which co-ordinates the work of national financial authorities, said today that work to strengthen methods of calculating alternative benchmarks was continuing, along with further regulatory reforms. It said “a great deal of progress” had been made in identifying alternatives to Libor in currency areas which currently rely on the benchmark while in some markets transition to those rates has begun.

In April, the Bank of England began publishing the Sterling Overnight Index Average and the U.S. Federal Reserve Board published the Secured Overnight Financing Rate. There are also plans from U.S. and U.K. authorities to create forward-looking term reference rates for dollars and sterling.

A euro short-term rate has been selected as a replacement for the existing benchmark, Eonia, and as a basis for the calculation of rates for contracts linked to Euribor.

FSB members and Isda are still working on strengthening the robustness of contracts in the face of the risk that Libor will be discontinued. As the FSB notes, the risk associated with the benchmark’s end is not confined to derivatives but applies also to syndicated loans, bonds and mortgages.

It became evident in 2012 that various banks had long made false claims about the interest rates they offered from which the overall Libor rate was thus falsely calculated. Numerous banks were fined as a result including Royal Bank of Scotland Group PLC, Deutsche Bank AG, UBS Group AG, and Barclays PLC while some traders were jailed. Following the scandal official support for Libor is set to be withdrawn after 2021.

The FSB said that authorities in markets across the world have worked to strengthen existing methods applied to interbank offered rates including the Euro Interbank Offered Rate and the Tokyo Interbank Offered Rate.

The aim is to make them more grounded in actual transactions. This is in contrast to Libor which is set after banks submit so-called expert judgments on interest rates. Twenty banks have agreed to continue doing this to set Libor till 2021. By this time a market-based alternative is expected to replace Libor as a benchmark for sterling-valued derivatives and other financial products, though it is not clear what will happen if this is not the case.