DISCONTINUATION OF LIBOR WHAT'S NEXT?

NEW INTEREST RATE BENCHMARKS WILL HAVE IMPACT ON MARKET PARTICIPANTS

Scotiabank™

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For more than 33 years, the London Interbank Offered Rate (LIBOR) has been the most cited benchmark reflecting the rate at which banks are willing to pay to borrow unsecured funds from each other. One of many interbank offered rates (IBORs), LIBOR underpins more than US$260 trillion in loans and derivatives globally[1].

On July 17, 2017, the UK Financial Conduct Authority announced that after the end of 2021, it will no longer compel or oblige panel banks to submit the data on which LIBOR is calculated and set. This decision reflects the views of global regulators that the continued use of IBORs is no longer reflective of market conditions. The purpose of this discussion is to provide some background on the phase-out of LIBOR and the possible scenarios that will emerge.

WHAT WILL REPLACE LIBOR?

Global regulators and governmental agencies have been investigating alternatives to LIBOR, and in the last few years have signalled the markets to lessen their use of IBORs in favour of alternative risk-free-rates (RFRs). The RFRs that have been selected in each IBOR market, as outlined in the following table, are rates based on more robust overnight markets and more reflective of interbank lending activity.

Expectations for alternative reference rates by jurisdiction

IBOR			Alternative Reference Rate					
IBOR	**Relevant working group**	**Expected date of IBOR discontinuation**	**RFR**	**Reference rate based on:**	**Secured or unsecured**	**Date RFR selected**	**RFR in use**	**Date of first publication of RFR**
USD LIBOR	Alternative Reference Rates Committee (ARRC)	End of 2021 *(expected)*	Secured Overnight Financing Rate **(SOFR)**	Borrowing rates for treasury backed deposits and repos	Secured Administrator: New York Federal Reserve Bank	June 2017	Yes	April 3, 2018
GBP LIBOR	Working Group on Sterling Risk-Free Rates	End of 2021 *(expected)*	Sterling Overnight Interbank Average Rate **(SONIA)**	Weighted average of unsecured overnight Sterling transactions	Unsecured Administrator: Bank of England	April 2017 (Reformed SONIA)	Yes	April 23, 2018 (reformed rate)
CHF LIBOR	Swiss National Working Group	End of 2021 *(expected)*	Swiss Average Overnight Rate **(SARON)**	Transactions and quotes published in the Swiss repo market	Secured Administrator: SIX Exchange	October 2017	Yes	2009
EUR LIBOR EURIBOR EONIA	Working Group on Euro Risk-Free Rates	**EONIA** January 3, 2022 **EUR LIBOR** End of 2021 **EURIBOR** Needs to be reformed by January 2022	Euro Short Term Rate **(€STR)**	Overnight unsecured fixed rate deposits	Unsecured Administrator: European Central Bank	May 2018	No	October 2, 2019
JPY LIBOR JPY TIBOR	The Study Group	**JPY LIBOR** End of 2021 *(expected)* **JPY TIBOR** Reform completed 2017	Tokyo Overnight Average Rate **(TONA)**	Volume weighted average of unsecured deposits	Unsecured Administrator: Bank of Japan	December 2016	Yes	1996
CDOR	Canadian Alternative Reference Rates Working Group (CARR)	Enhancement only, unlikely to be discontinued	Canadian Overnight Repo Rate **(CORRA)**	Volume weighted average of overnight repo transactions	Secured Administrator: Thomson Reuters	July 2018	Yes	1997

Data as of March 31, 2019.

The phase-out of LIBOR and other IBORs will impact market participants, particularly in loans and derivatives.

WHY DO FINANCIAL MARKETS NEED ALTERNATIVES TO LIBOR?

While the precursor to LIBOR was first used as a benchmark rate in 1969, LIBOR was established in 1986, when traders at various banks began providing daily estimates of the interest rate at which they believed they could borrow funds on an unsecured basis. LIBOR eventually became the standard benchmark in derivatives markets.[2] However, since the 2008 financial crisis, concerns regarding the subjectivity of underlying data arose along with recognition of the continually shrinking market of unsecured lending on which LIBOR is based.

HOW WILL THE CHANGES TAKE PLACE?

Phasing out LIBOR requires coordination among private and public sector institutions. Organizations like the Alternative Reference Rates Committee (ARRC), which was convened by the U.S. Federal Reserve Board and Federal Reserve Bank of New York, have been leading the transition away from U.S. dollar LIBOR, and were instrumental in selecting the proposed replacement rate, the Secured Overnight Financing Rate (SOFR). The previous table also outlines the key jurisdictions, in which RFRs have been selected, the timing around the introduction of new RFRs and the dates for the expected discontinuation of the relevant IBORs.

Currently, no plans to discontinue the Canadian Dollar Offered Rate (CDOR) exist. However, the Bank of Canada and the Canadian Alternative Reference Rate Working Group have selected an alternative RFR for CDOR: the Canadian Overnight Repo Rate (CORRA), which will reflect similar underlying markets as other RFRs. Unlike in LIBOR markets where transitions will be required to an alternative RFR, CDOR and CORRA will be concurrently available.

WHAT'S THE ROAD AHEAD FOR REFERENCE RATES?

While the phase-out of LIBOR will take place over time, as LIBOR has been used as a benchmark reference rate for many financial instruments, such as corporate loans, mortgages, floating-rate notes, derivatives (including interest-rate swaps) and virtually all adjustable-rate financial products, it is recommended that market participants undertake reviews of their portfolios and assess their exposures to LIBOR.

Scotiabank is closely monitoring the changes to interest rate benchmarks and the adoption of RFRs in order to ensure the smoothest possible transition for its clients and counterparties.

1. "The end of LIBOR," *The Economist*, September 27, 2018.
2. Gavin Finch and Liam Vaughan, "The Man Who Invented the World's Most Important Number," *Bloomberg*, November 29, 2016.

Additional Information

Should you need any further information, please refer to our [Frequently Asked Questions](), or contact:

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