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## Global Benchmark Interest Rates

### Why in news?

Financial institutions are yet to facilitate an absolute transition away from the London Interbank Offered Rate (LIBOR) benchmark.

### What is London Interbank Offered Rate (LIBOR) benchmark?

- **Transparency** - LIBOR was created in the 1970s as a way to provide a more transparent and efficient way to set interest rates.
- **Global bench mark interest rate** - LIBOR or London Interbank Offered Rate is a global benchmark interest rate.
- **Estimated interest rate** - LIBOR is calculated daily based on the estimated interest rates at which banks can borrow unsecured funds from other banks in the London wholesale or interbank market.
- **Reference rate** - LIBOR is used as a reference rate for a wide range of financial products including floating-rate loans, derivatives, and securities.

### What are the issues associated with LIBOR?

- **Central flaw** - LIBOR relies heavily on banks to be honest with their reporting disregarding their commercial interests.
- **Manipulation by banks** - The manipulation was particularly on display during the 2008 financial crisis when submissions were artificially lowered.
- In 2012 it was also revealed that some banks had been manipulating LIBOR rates in order to profit from their own trading positions.
- **Phase out** - In 2021 the UK's Financial Conduct Authority (FCA) announced that it would be phasing out LIBOR by the end of 2023.
- **Concerns in India** - RBI stated that both LIBOR and MIFOR would cease to be a representative benchmark from June 30 2023.

*The interbank market is an informal market where banks borrow from and lend to each other with established internal limits based on an institution's risk appetite.*

### What are the alternates to LIBOR?

- **Secured Overnight Financing Rate (SOFR)** - Is a broad measure of the cost of

borrowing cash overnight collateralized by Treasury securities.

- In 2017 the U.S. Federal Reserve that SOFR as a preferred alternative to LIBOR.
- **Mumbai Interbank Forward Offer Rate (MIFOR)** - Is the rate that Indian banks use as a benchmark for setting prices on forward-rate agreements and derivatives.
- MIFOR is a mix of the London Interbank Offered Rate and a forward premium derived from Indian forex markets.
- RBI issued an advisory in mid-2021 encouraging all national banks to stop using MIFOR for new contracts by the end of 2021 as a result of the plan to phase out LIBOR.
- **Modified Mumbai Interbank Forward Outright Rate (MMIFOR)** - It would be used to adjust SOFR among other components.
- **SOFR and MMIFOR** - In India **new transactions** were to be undertaken using the SOFR and the Modified Mumbai Interbank Forward Outright Rate (MMIFOR), replacing MIFOR.
- It is based on **observable repo rates**, or the cost of borrowing cash overnight, which is collateralized by U.S. Treasury securities.
- This would make it potentially less prone to market manipulation.

### What are the challenges faced by the banks?

- Indian Banks' Association said that there were many products linked to LIBOR which had to be redesigned with an alternate reference rate (ARR) as the base.
- Challenges related to technology and legal aspects (such as handling of legacy contracts, modification of contracts with the counter parties/interbank as well as borrowers).
- Banks have to intimate the customers about the transition, insertion of fallback clause in the contracts, assessment of the impact on their P&L, changes in the technology platform and so on.
- Some banks and financial institutions were yet to facilitate an absolute transition away from the London Interbank Offered Rate (LIBOR) benchmark due to fallback clauses.

### Quick facts

#### International Finance Corporation (IFC)

- IFC was founded in **1956** with a key objective that the private sector has the potential to transform developing countries.
- IFC is a **member of the World Bank Group**, advances economic development and improves the lives of people by encouraging the growth of the private sector in developing countries.
- IFC is the largest global development institution focused on the private sector in developing countries.

### Reference

1. [The Hindu | Issues With LIBOR](#)



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