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LIBOR and “No-Deal” Brexit

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One of the consequences of a “no-deal” Brexit would be that the United Kingdom would no longer have access to the European financial market. This would affect LIBOR as a trusted and widely used benchmark.

LIBOR vs. EURIBOR

Currently, two relevant benchmarks exist in the European Union: LIBOR and EURIBOR. LIBOR stands for “London Interbank Offered Rate” and is a benchmark that is used for – among other things – loans based on Loan Market Association documentation. LIBOR is made available in five different currencies: U.S. dollar, British pound, Japanese yen, Swiss franc, and euro. EURIBOR stands for “Euro Interbank Offered Rate” and is, simply put, the interest rate at which European banks lend money to each other. EURIBOR is only available in euros. Both benchmarks are determined daily, but while LIBOR focuses on the London banking system, EURIBOR takes into account the entire European Union.

Developments around LIBOR

LIBOR has been the subject of increased scrutiny after it emerged that certain banks had manipulated LIBOR rates. Furthermore, insufficient activity in the unsecured interbank market raised questions about the sustainability of the LIBOR benchmark. Closely related to these developments is the new EU Benchmarks Regulation (EU) nr. 2016/11 and the development of a new secured overnight interest rate by the European Central Bank (ECB). The Benchmarks Regulation went into effect on 1 January 2018 and includes a two-year transitional period. The new interest rate for the euro will be based on data already available to the Eurosystem and is anticipated to be finalized before 2020.

The Future of LIBOR

Andrew Bailey, chief executive of the UK Financial Conduct Authority (FCA), has spoken to all current panel banks about agreeing voluntarily to sustain LIBOR until the end of 2021. However, a “no-deal” Brexit most likely will cause LIBOR to lose its authorized benchmark status in the European Union. This would leave nine months for the reference rate’s administrator to reapply as a third-country provider. Thus, even if LIBOR survives until 2020, a no-deal Brexit could come with enormous risks.

Takeaway

Market participants may wish to review and consider the amendment and waivers provision in loan agreements being concluded now, taking into account a possible “no-deal” Brexit and the development of the new overnight interest rate by the ECB. Furthermore, lenders should closely review the requirements posed by the Benchmarks Regulation to ensure they are compliant with its provisions.

Lotte Kuhn contributed to this article, and she is not admitted to the practice of law.

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