Financial Conduct Authority UK

FCA: Libor to end in 2021

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7 HOURS AGO by: Martin Arnold, Emma Dunkley, Paul McClean

The head of the Financial Conduct Authority has revealed that Libor, the inter-bank lending rate at the centre of a multi-year scandal, will be phased out in 2021, as regulators look to replace it with a more reliable alternative.Andrew Bailey said in a speech in London on Thursday morning that Libor was unable to fulfill its objective of capturing the cost of banks borrowing from each other because this activity has fallen so sharply since the 2008 financial crisis.

While the FCA boss said there had been significant governance improvements by the banks that submit rates to make up Libor and he had no evidence of any fresh attempts to rig the benchmark, he said the current situation was unsustainable.

In a speech at Bloomberg's London office, Andrew Bailey said the market supporting Libor was no longer "sufficiently active", and that this raised "serious questions" about its future.

"We do not think we will complete the journey to transaction-based benchmarks if markets continue to rely on Libor in its current form," he said.

Libor came under the spotlight after evidence emerged that it was being manipulated by some of the largest global banks during the financial crisis.

Libor is the rate at which banks lend to each other, setting a benchmark for the price of mortgages, loans and other financial contracts.

It also gives an indication of a bank's borrowing costs. The lower the rate, the more creditworthy a bank is deemed to be. At the onset of the financial crisis in 2008, it became a closely watched indicator of a bank's health.

But a number of banks manipulated Libor through the economic meltdown, to give a healthier picture of their credit quality.

Banks have been fined about $9bn to date for rigging the rates they submitted, including a £290m fine imposed on Barclays.

"What I will say this morning does question the sustainability of Libor in its current form, but this is not because we suspect further wrongdoing or have any evidence of such," said Mr Bailey.

"The absence of active underlying markets raises a serious question about the sustainability of the Libor benchmarks that are based upon these markets," Mr Bailey said. "If an active market does not exist, how can even the best run benchmark measure it?"

The FCA boss said the process of transitioning away from Libor to alternative interest rate benchmarks would take four to five years. He said the FCA had persuaded banks to voluntarily continue producing Libor during that time, after which he expected the market to shift to alternative measures.

"There is a very important question here to which we need a robust answer, namely whether the better approach to transition would be to amend contracts to reference an alternative rate, or amend the definition of Libor through the fallback protocol to replace the current methodology with alternative reference rates."

He added that while the FCA has been able to persuade 20 banks ton continue submitting rates to calculate Libor, they "feel understandable discomfort about providing submissions based on judgements with so little actual borrowing activity against which to validate those judgements".

He said that a number of alternative benchmarks have already been put forward as suitable replacements by the industry, including the UK's Sonia. "Work must therefore begin in earnest on planning transition to alternative reference rates that are based firmly on transactions."

The move comes after Chris Salmon, executive director for markets at the Bank of England last week said he wanted to move to a "less Libor-centric world".