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SMALLER FIRMS WARY AMID SHIFT AWAY FROM LIBOR, SAY BANKS

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MUMBAI : Despite the move away from the London Interbank Offered Rate (Libor), several corporate borrowers, especially smaller Indian companies, are reluctant to embrace alternative reference rates, fearing changes in borrowing cost and, to some extent, due to lack of awareness, bankers said.

“While several large corporates have recently raised funds using the secured overnight financing rate (SOFR), an alternative reference rate (ARR), smaller clients are still wary. There is a great deal of inertia in the treasury departments of smaller corporate borrowers. We are explaining to them about the changes in spread once they move to the new benchmark, and it is a work in progress," said a senior banker.

The global transition from Libor was necessitated after British financial authorities decided to phase it out in 2017 after discovering that some large banks manipulated the reference rate up or down by providing false data. Traditionally, the interest rates for most Indian corporates availing of external commercial borrowings (ECBs) are benchmarked to the three-month or six-month Libor rate.

Indian banks are adding a fallback clause or replacement rates to existing overseas loan agreements to ensure a smooth transition from Libor. While most Libor benchmarks have ceased to exist after 31 December, the remaining will become inactive after June next year.

In preparation for the transition, lenders are enabling systems to capture the alternative SOFR and educating clients about the benefits of the transition. The SOFR is a benchmark interest rate published by the New York Fed that banks use to price US dollar-denominated derivatives and loans.

“At State Bank of India, we have prepared our systems for ARR, including direct upload. We have introduced fallback clauses to ARR in all documents expiring beyond the cut-off date. ARR adoption in India will pick up pace closer to the cut-off date after which the published Libor rate may not be available," said Ashwini Kumar Tewari, managing director (international banking, technology and subsidiaries) at State Bank of India.

Libor reference rates were calculated as averages of rates polled by major banks and used for pricing debt instruments and derivatives such as currency swaps and interest rate swaps.

“For ECBs, banks are becoming very choosy to give borrowers the Libor option because the benchmark anyway has a sunset in 2023 and therefore, a three-year loan on it does not make sense," said Ashutosh Khajuria, executive director and chief financial officer at Federal Bank, adding that if the loan contract is for a year or six months, technically borrowers can still use Libor.

While ECB term loans can range from 3-7 years, working capital loans are of shorter duration.

Khajuria added that Libor was also used for quoting Foreign Currency Non-Resident (FCNR) deposit rates but had been stopped since 1 January, and all FCNR deposits are being quoted on SOFR only. These are fixed deposits by non-resident Indians held in domestic banks in foreign currency.

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