

INSIGHT: HOW THE EXIT OF LIBOR WILL IMPACT THE NIGERIAN FINANCIAL MARKET

Onyinyechi Endaline Iwuoha*

ABSTRACT

From the brass rods of Belgian Congo to the domesticated reindeer of Northern Siberia, the relationship between loans and interest rates is as old as time. During the primitive era, a creditor would always expect to receive his credit (a cow) and interest (a calf) from the debtor. It is therefore not surprising that interest rates have grown to play a huge role in the development of financial systems of economies. The popularity of the London Interbank Offered Rate (LIBOR) lends credence to the importance of interest rates in the syndicated loan market as well as the global financial market. However, as with all things subject to human control, cases of interest rate manipulations and various forms of financial misconduct as it relates to the LIBOR has arisen leading to the noticeable decline in its use and the call for its replacement. While a case can be made for the use of interest rate benchmarks other than LIBOR, there is clearly a huge role that LIBOR plays in financial markets for which there is no immediately obvious alternative; hence the argument in some quarters for a reform rather than a replacement of LIBOR. Despite the call by the proponents of a reform, Andrew Bailey, Chief Executive of the Financial Conduct Authority (FCA) announced that LIBOR would be phased out by the year 2021. This raises the important question – how will this affect the Nigerian financial market, which is wholly dependent on the LIBOR rates for its foreign currency-denominated loans and derivative trading? That is the issue which this paper will address. It will also address the reliance on LIBOR by the Nigerian financial institutions. The paper submits that it is in the interest of the Nigerian financial institutions to seek out an alternative reference rate and move towards the amendment of existing LIBOR-reliant documentations.

Keywords: *Interest Rate, LIBOR, Financial Market, Loan Documentation, Capital Market, Derivatives.*

INTRODUCTION

The history of interest rates can be traced to medieval times and is closely linked with the evolution of credit. It has been said that credit antedated industry, banking and primitive forms of money. Loans at interest may have started when the Neolithic farmer made a loan of seed to a cousin and expected more back at harvest time.¹ Loans without interests were seen as gifts while loans given for productive purposes were expected to be returned with interests. The earliest historical records show that credit accompanied by interest was a common phenomenon, especially loans of seed and animals. Seeds yielded an increase and at harvest time could be returned with interest. Expectedly, with the advent of legal tenders, the interest rates applied to these primitive forms of credit began to

* **The author is a Senior Associate in the Corporate/Commercial Practice Group at The New Practice (TNP) law firm. She is ranked as a “Rising Star” in Banking and Project Finance in Nigeria by the International Financial Law Review (IFLR 1000).**

1. Sidney Homer and Richard Sylla, *A history of interest rates* (3rd edn, rev, Rutgers University Press 1996).



take a formal structure.² An analysis of the economic growth in countries such as Brazil, Turkey, India and Chile showed the long-term economic growth attributable to interest rates.³ A rise in interest rates saw a decline in inflation rate and volatility as well as an increase in foreign direct and portfolio investments.⁴ As such, interest rates have evolved to become a key indicator for financial markets which has a symbiotic relationship with the economy of a country.

Interest rates have greatly influenced the syndicated loan market. Financial innovations that are bred by the players in the syndicated loan market have helped to develop an efficient primary market and a liquid secondary market.⁵ Borrowers and commercial banks rely on benchmark rates to trade in private and public fixed income markets and high yield bonds.⁶ These benchmark rates are interest rates provided by a panel of selected banks; it is this need for dependable rates from quality market players that led to the creation of LIBOR and other reference rates. The rise of the LIBOR has been premised on the fact that banks need to know the interest rate at which to lend so that there is a semblance of uniformity in the financial market. To those unlearned in the workings of the market, the question that would arise would be, why? Why are banks looking for a benchmark or reference interest rate before they can lend money? The answer to this question is rooted in the essential role banks play in the stability of various global economies. The impact of this role was underscored with the global financial crisis of 2007/2008 and the findings of manipulation of LIBOR rates by global banks.

LIBOR has been used by financial markets across the globe since the early 1980s as a reference⁷ and benchmark⁸ rate to determine the interest rate payable in financing transactions. These transactions are usually denominated in US Dollars, Pound Sterling, Euro, Swiss Franc and Japanese Yen. The banks in Nigeria, one of the developing economies in Sub-Saharan Africa, are not left out in the LIBOR furor. Virtually every loan transaction that has an international counterparty, such as a development financial institution or export credit agency or is denominated in a currency other than the Nigerian Naira, has been benchmarked using the LIBOR. Trading in the Nigerian capital market also uses LIBOR as a reference rate. It is therefore understandable that the LIBOR manipulations and consequent phasing out in 2021 will also affect the Nigerian financial market.

This paper discusses the advent of LIBOR and how it became the most important rate in the global market. It also discusses the global financial crisis and the role global banks played in the manipulation of the LIBOR rates resulting in the push to phase out the LIBOR as advocated in the Wheatley Report,⁹ and the speech by Andrew Bailey, Chief Executive of the (UK) Financial

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2. *ibid.*
 3. Sergey Drobyshevsky and others, 'Effect of Interest Rates on Economic Growth' (Moscow 2017) <<https://www.iep.ru/files/RePEc/gai/ppaper/ppaper-2017-303.pdf>> accessed 1 June 2020.
 4. *ibid.*
 5. Glenn Yago and Donald McCarthy, *The US Leveraged Loan Market: A Primer* (Milken Institute 2004) <https://assets1c.milkeninstitute.org/assets/Publication/ResearchReport/PDF/loan_primer_1004.pdf> accessed 1 June 2020.
 6. *ibid.*
 7. A reference rate is a rate used by financial institutions to determine the contract terms of various financial instruments.
 8. A benchmark rate is an interest rate that is used to measure the performance of derivative instruments such as floating-rate security or interest rate swap.
 9. HM Treasury, *The Wheatley Review of LIBOR – Final Report* (September 2012) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/191762/wheatley_review_libor_finalreport_280912.pdf> accessed 1 June 2020.



Conduct Authority (FCA).¹⁰ This paper also highlights the mistrust of financial market players in the rates provided by LIBOR due to the findings of manipulation and interest rate fixings by panel banks to present a façade of financial stability. It also discusses the options available to developing countries, specifically Nigeria, and steps that can be taken to amend existing facilities granted using LIBOR as a reference rate post-2021.

THE RISE AND FALL OF LIBOR

The story is told that in 1969, a Greek banker, Minos Zombanakis, unwittingly engineered the creation of LIBOR. This, he did by arranging for the signing of a US\$80 million loan granted to the Shah of Iran by Manufacturers Hanover Corporation. The interest rate that was applied was split across several banks; a process by which the banks provide their highest and lowest rates for lending and the average rate is what would be applied on the loan in question. It was one of the first loans to create the concept of splitting interest rates that reflected the changing market conditions amongst a syndicate of banks.¹¹

The LIBOR formula as designed by Zombanakis was simple – the banks in the syndicate would provide their cost of lending on revolving loans. The highest and lowest rates are discarded, and the average of the remaining rates becomes the applicable interest rate. This interest rate will be recalculated every few months. This formula became widespread and contributed to the astronomical rise of the syndicated loan market in the early 1980s to about US\$40 billion.¹² It is therefore unsurprising that such a simplistic formula rose to become the benchmark for pricing loans and other derivative products worth billions of dollars leading to its codification as a standard interest rate benchmark.¹³ Financial markets across the globe relied on this informal data collection process, and after a while, the submitting banks realised that the figures could be manipulated, and it was indeed manipulated, to present a false narrative on the financial standing of some of the global banks. This manipulation was done by presenting suspiciously low or unusually high rates that enabled the banks shift LIBOR, thereby making huge profits or make banks appear healthier than they were. This led to the clamour for a formal data collection and governance process as financial market players had begun to suspect that there was a high probability that panel banks were taking advantage of their role as interest rate submission banks in an unfavourable manner.¹⁴

In 1984, the British Bankers' Association (BBA) developed and administered the standardised rate through BBA Libor Limited, and this was published as BBA Libor from 1986-2014.¹⁵ Although LIBOR became the most important number in the financial market, it was its adoption by the Chicago Mercantile Exchange as the reference rate for Eurodollar¹⁶ futures contracts that solidified its position.¹⁷ By 2012, the BBA had reported the rates for over ten (10) currencies with

10. Andrew Bailey, 'The Future of LIBOR' (Speech given at Bloomberg, London, 27 July 2017). <<https://www.fca.org.uk/news/speeches/the-future-of-libor>> accessed 2 June 2020.
11. Gavin Finch and Liam Vaughan, 'The Man Who Invented the World's Most Important Number' (*Bloomberg Market*, 29 November 2016) <<https://www.bloomberg.com/news/features/2016-11-29/the-man-who-invented-libor-iw3fpmcd>> accessed 1 June 2020.
12. *ibid.*
13. *ibid.*
14. HM Treasury (n 9).
15. ICE Benchmark Administration, *Roadmap for ICE LIBOR* (18 March 2016) <https://www.theice.com/publicdocs/ICE_LIBOR_Roadmap0316.pdf> accessed 1 June 2020.
16. The term Eurodollar refers to US dollar-denominated deposits held by American banks in foreign banks or at the overseas branches of American banks. These deposits are not subject to regulation by the Federal Reserve Board, including reserve requirements because they are held outside the United States.
17. Bailey (n 10).



fifteen (15) maturity terms ranging from overnight to a 1-year term. According to Hue and Skeie,¹⁸ the question posed by the BBA to the panel banks, who were the largest banks with the highest credit ratings, were as follows, '*At what rate could you borrow funds, were you to do so by asking for and then accepting interbank offers in a reasonable market size just prior to 11 am?*'¹⁹

Having analysed the rise of LIBOR to global dominance, it is not incorrect to state that its downfall was precipitated by the scandals and reports of collusion by the global banks who were the anchors of most economies. The beginning of the fall started before the global financial crisis of 2007/2008. As is their custom, financial market players monitored the movement of LIBOR and other short-term interest rates such as Treasury yields and the Overnight Index Swap (OIS) rate.²⁰ Based on their analysis, these rates moved closely with LIBOR, as such no foul play was suspected. However, at the onset of the financial crisis, as would be examined below, it became glaring to market observers and players that there was something wrong with the LIBOR rates submitted by the panel banks.²¹

Due to the rising financial crisis at that time, an unanticipated problem developed – liquidity risks. Banks were reluctant to enter long term financing that would tie up their funds. The resultant effect was that there was an increase in demand for interbank funds but inadequate supply to meet the demands. This, in addition to the downward review of the credit ratings of most banks as a result of the crisis, skyrocketed LIBOR rates.²² Even after the global financial crisis, the LIBOR never fully recovered as it was besieged by controversies such as reports of inaccuracies and intentional manipulation by some of the panel banks.²³ The evidence of collusion stemmed not from investigative news reports but from regulator investigations requiring banks to divulge electronic communication records including trading room phone calls and messaging services.²⁴ Some of the prominent banks caught in the LIBOR web of lies include Barclays Bank,²⁵ Deutsche Bank AG,²⁶ amongst others.

The LIBOR Scandal and the Reformation of Reference Rates

Mid 2012, LIBOR was again a cause for public concern — inadvertently setting the stage for the rise of alternative reference rates. The unsupervised nature of the submissions by the panel banks and the conflicts of interest that went unaddressed were some of the issues put forward by proponents of alternative reference rates. In addition, some of the panel banks were accused of padding the numbers by under-reporting their costs of borrowing to create a false narrative of financial stability.²⁷ The major culprits of the LIBOR scandal were Barclays, UBS, RBS and Rabobank, and these banks have paid a cumulative sum of over US\$3.5 billion as fines to regulatory

18. HM Treasury (n 9).

19. *ibid.*

20. *ibid.*

21. *ibid.*

22. *ibid.*

23. *ibid.*

24. *ibid.*

25. Barclays Bank was fined Euros 284,432,000 for financial misconduct by the Financial Conduct Authority (FCA). See Financial Conduct Authority, 'Final Notice to Barclays Bank Plc' (FCA Ref 122702, 20 May 2015) <<https://www.fca.org.uk/publication/final-notice/barclays-bank-plc-may-15.pdf>> accessed 1 June 2020.

26. Financial Conduct Authority, 'Final Notice to Deutsche Bank AG' (FCA Ref 150018, 21 August 2014) <<https://www.fca.org.uk/publication/final-notice/deutsche-bank-ag.pdf>> accessed 1 June 2020.

27. *ibid.*



bodies including the United States Department of Justice and the United Kingdom's Financial Services Authority.²⁸ Not only did these banks pay heavy fines as punishment for their misconduct, some of the senior executives also resigned, including the Chief Executive Officer of Barclays, Robert Diamond, who resigned on 3 July 2012.²⁹

In the wake of the LIBOR scandal, there were calls by regulatory bodies for the reformation of the LIBOR rates. Organisations such as the International Organization of Securities Commissions (IOSCO) and Bank for International Settlements (BIS) were at the forefront of the LIBOR reformation agenda.³⁰ In the United Kingdom, the Chancellor of the Exchequer commissioned the Wheatley Review.³¹ The key objectives of the review were three-fold and identified as:

- a. the need for the current LIBOR framework to be reformed with the rate-setting and governance clearly spelt out;
- b. the need for adequate sanctions to appropriately deal with issues of LIBOR abuse; and
- c. to analyse and determine whether the weaknesses of LIBOR impacted other global benchmarks.³²

Some of the weaknesses of LIBOR identified by the Wheatley report were:³³

- a. *The misuse of LIBOR* - LIBOR was always intended to represent the cost of unsecured inter-bank term borrowings. However, due to the decline in the availability of this type of inter-bank borrowings, the rates submitted by the panel banks were not based on actual data but expert judgment.
- b. *Ease of manipulation* – the report also identified that the mechanism for administering LIBOR coupled with the additional incentive of panel banks to maintain creditworthiness made it easy for the submissions to be manipulated. The panel banks that constituted the reference banks were the big banks which supposedly had integrity and high ratings. These banks were the players in the financial market, as such, the rates submitted by the banks were not always questioned. This created an easy avenue for the rates to be manipulated. By adjusting the rates and shifting LIBOR by a little margin, the reference banks could appear to be healthy, thus, leading to further financial misconduct as other banks and market participants relied on the "health" of the banks to conduct their dealings.

The Wheatley report further identified that to restore faith in LIBOR, there was a need for greater transparency and independence. It was also argued that a good governance regime would contribute to a trusted submission and compilation process.³⁴

28. Bailey (n 10).

29. HM Treasury (n 9).

30. *ibid.*

31. *ibid.* Following the findings of misconduct by the then Financial Services Authority (FSA) against Barclays Bank in 2012, the UK Government asked Martin Wheatley, managing director of the FSA to establish an independent review into a number of aspects of the setting and usage of LIBOR.

32. HM Treasury (n 9). The final report of the Wheatley Committee was published September 2012.

33. HM Treasury (n 9).

34. *ibid.*



Questions about the sustainability of LIBOR benchmarks were addressed by Andrew Bailey, the Chief Executive of the Financial Conduct Authority (FCA) at Bloomberg.³⁵ One of the reforms highlighted by the FCA³⁶ was that LIBOR submissions and rates should be anchored on actual transactions. While identifying the key improvements made by ICE Benchmark Administration (IBA),³⁷ Bailey raised the point that the absence of unsecured wholesale bank borrowings has exposed the underlying issue of the sustainability of LIBOR. Consequently, he advised that work should begin on identifying and transitioning to other alternative reference rates based on actual transactions as the FCA would not persuade the panel banks to continue submissions.³⁸

THE NIGERIAN LOAN MARKET AND THE LIBOR SCANDAL

Unlike the Nigerian Interbank Offered Rate (NIBOR), LIBOR is often used in Nigeria where the currency of the transaction is not the Nigerian Naira, usually US Dollar, Pound Sterling or other currency published by LIBOR. It is also common for transactions with international counterparties such as the International Monetary Fund (IMF), World Bank, Africa Development Bank to have the interest rates benchmarked on the LIBOR. The country's capital market also relies on the LIBOR rates for its derivatives trading.³⁹

Nigeria was not left unscathed as the impact of the global financial crisis was felt in the various sectors of the Nigerian economy. In the oil and gas sector, which is the Nigerian government's cash cow, the foreign exchange earnings dropped significantly after the oil price slump⁴⁰ caused by speculative pressures during the crisis. Consequently, the Federal Government of Nigeria relied on the funds in the country's excess crude account to make up the shortfall in its budget.⁴¹ Other consequences of the global financial crisis included:⁴²

- a. The decline in foreign direct investment, portfolio investment, overseas development assistance and remittances and other forms of global financial flow to Nigeria as a result of the restriction by the developed economies who were, at that same time, grappling with the crisis and battling to stabilise their economies;
- b. Significant divestment by foreign investors in Nigeria's stock market, notably portfolio investors who divested and repatriated their profits back home in the face of the credit squeeze;

35. Bailey (n 10).

36. *ibid.* The FCA is an agency of the UK government with powers to investigate and regulate financial markets, including LIBOR.

37. The IBA took over from the BBA and became the new administrator in February 2014 based on the recommendation of the Wheatley Review. The IBA is an independent UK subsidiary of the private US-based exchange operator Intercontinental Exchange or ICE.

38. The IBA and the LIBOR panel banks are regulated by the FCA. FCA announced on 24 November 2017 that it had secured the voluntary agreement of all 20 LIBOR panel banks to continue submitting contributions until the end of 2021.

39. Ikemefuna Stephen Nwoye, 'Discontinuation of LIBOR: Possible Impacts on Nigerian Corporate and Sovereign Financing' (29 July 2019) <<http://dx.doi.org/10.2139/ssrn.3427979>> accessed 1 June 2020.

40. Crude oil price fell to US\$50 per barrel in November 2008 from the peak price of US\$147 per barrel in July 2018.

41. Abimbola Hakeem Omotola, 'Impact of the Global Financial Crisis on the Nigerian economy' (*ProshareNg*, 11 November 2013) <<https://www.proshareng.com/news/Nigeria-Economy/Impact-of-the-Global-Financial-Crisis-on-the-Nigerian-Economy/21539>> accessed 19 June 2020.

42. Sanusi Lamido Sanusi, 'The Impact of the Global Financial Crisis on the Nigerian Capital Market and the Reforms' (7th Annual Pearl Awards and Public Lecture, Muson Centre, Lagos, 27 May 2011). <https://www.academia.edu/10360076/The_Impact_of_the_Global_Financial_Crisis_on_the_Nigerian_Capital_Market_and_the_Reforms_By_Mallam_Sanus_Lamido_Sanus_Governor_Central_Bank_of_Nigeria_Presented_at_the_7th_Annual_Pearl_Awards_and_Public_Lecture_Held_at_the_Muson_Centre_Onikan_Lagos> accessed 20 June 2020.



- c. Unavailability of credit to Nigerian banks by their foreign counterparts and other international financial institutions.

Having experienced the negative impact of the global financial crisis and how the LIBOR scandal contributed, it would be prudent if Nigeria joined the alternative reference rate debate. However, there has been no move towards an alternative reference rate, and this is not unconnected with Nigeria's reliance on the Loan Market Association (LMA) documentation templates and the International Swap Dealers Association (ISDA) documents which was originally based on the LIBOR benchmark rates. These loan documentation templates are yet to be amended to reflect the proposed alternatives to LIBOR. As such, Nigerian banks are still relying on LIBOR rates in their transactions with their international counterparts. It is expected that Nigeria's move from LIBOR to other alternative rates would be motivated by the actions of other financial markets. Already, the LMA and ISDA have started making plans towards preparing documentations that has the option of other reference rates.

The need for an alternative rate was buttressed by Bailey when he stated:

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.⁴³

Hou and Skeie posed similar questions –

Should it be structured like LIBOR to reflect bank credit risk, or should it be conceived as a risk-free rate in the vein of OIS? Should it remain an uncollateralised rate or reflect collateralised lending? Should it be constructed as a single rate or as a composition of multiple rates? Should it be quoted for a range of maturities or solely reported on an overnight basis? Should it be calculated using terms on actual market transactions or rely on discretionary submissions?

These questions coupled with the FCA's stance on submissions by panel banks have led market players such as Standard Chartered to start a transitioning road map aimed at educating their customers on the end of LIBOR and the transitioning to risk-free rates.⁴⁴

HOW FINANCIAL MARKET PLAYERS ARE RESPONDING – ALTERNATIVE REFERENCE RATES, LMA REFERENCE AGREEMENT

One of the foremost alternative reference rates was the "New York Funding Rate" aimed at replacing the beleaguered LIBOR. Quotes for the New York Funding Rate are submitted anonymously to negate any report of inaccuracy as seen during the LIBOR scandal⁴⁵. Other alternative rates include:

43. Bailey (n 10).
 44. Standard Chartered LIBOR Newsletter - <<https://www.sc.com/en/banking/libor/>> accessed 4 June 2020.
 45. Connan Andrew Snider and Thomas Youle, 'Does the LIBOR Reflect Banks' Borrowing Costs?' (2 April 2010) <<http://dx.doi.org/10.2139/ssrn.1569603>> accessed 1 June 2020.



Secured Overnight Financing Rate (SOFR)

The SOFR is administered and published by the Federal Reserve Bank of New York.⁴⁶ This was based on the recommendation of the Alternative Reference Rates Committee (ARRC) that the US LIBOR should be replaced with a rate derived from a repurchase agreement with Treasury securities as collateral.⁴⁷ As such, the major difference between the US dollar London Interbank Rate (US LIBOR) and SOFR is that the US LIBOR is the rate used for unsecured borrowings while the SOFR is a secured borrowing rate which financial institutions in the US borrow dollars overnight while using the US Treasury bonds as security.⁴⁸

Sterling Overnight Interest Average Rate (SONIA)

The SONIA was introduced in March 1997. It is governed and administrated by the Bank of England which took over responsibility from the Wholesale Markets Brokers Administration (WMBA) in 2016 and published its reform in 2018.⁴⁹ The SONIA rates are based on actual transactions submitted to the Bank of England, who thereafter, determine the average interest rate that banks pay to borrow Sterling overnight. Some of the reforms introduced by the Bank of England include: (i) taking over the calculation and publication of the SONIA from the WMBA; and (ii) including bilateral overnight secured transactions in the data used to calculate the SONIA.⁵⁰

Tokyo Overnight Rate (TONAR)

The TONAR is an unsecured, transaction-based benchmark for the robust uncollateralised overnight call rate market. This is administered by the Bank of Japan and was launched following studies with a group of Japanese and international banks.⁵¹ The Bank of Japan calculates and publishes the rate daily using the information provided by money market brokers known as Tanshi.⁵² It has been identified as a LIBOR alternative by the Bank of Japan and serves as the reference rate for the Japanese Yen (JPY) Overnight Index Swap (OIS) market.⁵³

Despite the identification of TONAR as a response to risk-free reference rates by the Bank of Japan, the transition to TONAR requires further market support momentum. This is because of the prior existence of the Tokyo Interbank Offered Rate (TIBOR) which is undergoing reform. Japanese banks and businesses are thus facing two competing rates and regulators have so far not decided which to favour. This decision has been left to a cross-industry committee of banks, brokers and companies. As it stands, 70% of companies prefer the forward-looking term rate based on the TONAR while 57% of bankers hold that TIBOR ought to be used as the alternative rate for loans.⁵⁴

46. Federal Reserve Bank of New York, 'Secured Overnight Financing Rate Data' <<https://apps.newyorkfed.org/markets/autorates/SOFR>> accessed 4 June 2020.

47. Jerome Powell, J Christopher Giancarlo, 'How to Fix LIBOR Pains' *Wall Street Journal* (Brussels, 7 August 2017).

48. Secured Overnight Financing Rate <<https://www.sofrate.com/>> accessed 4 June 2020.

49. Bank of England, 'SONIA Interest Rate Benchmark' <<https://www.bankofengland.co.uk/markets/sonia-benchmark>> accessed 3 June 2020.

50. *ibid.*

51. Matthieu Sachot and Olivier Garcia, 'The end of IBOR - the Asia take, Regulation Asia' (*Bloomberg*, 8 November 2018) <<https://www.bloomberg.com/professional/blog/end-ibor-asia-take/>> accessed 5 June 2020.

52. Ernst & Young, 'IBOR Transition: A Swiss Perspective' (*EY*, August 2018) <<https://www.ey.com/ch/en/Publications/20181203-Swiss-perspective-on-IBOR-transition/download>> accessed 5 June 2020.

53. Bank of Japan, *Report on the Identification of a Japanese Yen Risk-Free Rate* (December 2016) <<https://www.boj.or.jp/en/paym/market/sg/rfr1612c.pdf>> accessed 5 June 2020.

54. Takashi Umekawa and Alun John, 'Japan's Banks and Borrowers Battle over Lending Benchmark as Clock Ticks on Libor, Reuters Business News' <<https://www.reuters.com/article/us-japan-libor-analysis/japans-banks-and-borrowers-battle-over-lending-benchmark-as-clock-ticks-on-libor-idUSKBN21L0KG>> (*Reuters*, 3 April 2020) accessed 5 June 2020.



Swiss Average Rate Overnight (SARON)

SARON is the overnight interest rate of the secured money market for Swiss Franc (CHF) and is administered by the SIX Swiss Exchange. It is based on concluded transactions and binding quotes posted in the Swiss repo market, a pivotal part of the Swiss Value Chain.⁵⁵ It was jointly developed by the Swiss National Bank and the Swiss Stock Exchange⁵⁶. It became the reference interbank overnight repo on 25 August 2009 after replacing the Tomorrow/Overnight Interest Swaps (TOIS) benchmark in December 2017.⁵⁷

Since the inception of LIBOR, the Swiss National Bank (SNB) has relied on it as the monetary policy reference rate. But in the wake of doubts trailing the LIBOR, the SNB decided to re-examine its relevance and usefulness as a benchmark. However, as the SNB can only operate in the secured money market, lending money to banks on a collateralised basis, it required an efficient secured money market to implement its monetary policy.⁵⁸

As one of the reference rates, SARON replaced the Repo Overnight Index which was previously used by the SNB as the basis for calculating the special rate for the liquidity-shortage financing facility and the penalty rate for non-compliance with the minimum reserve requirements.⁵⁹

US American Interbank Offered Rate (Ameribor)

The Ameribor represents unsecured overnight lending taking place across the American Financial Exchange (AFX) which was established in December 2015 in collaboration with the Chicago Board Options Exchange (CBOE).⁶⁰ The American Financial Exchange was created by Richard Sandor widely regarded as '*the father of Financial Futures*'.

Prior to the launch of the AFX, Sandor created the Ameribor, following his desire '*to create an American interest rate benchmark, one that sets rates based on the actual borrowing and lending done by small and mid-sized banks in the US*'.⁶¹ This desire was birthed in the wake of the changes occasioned by manipulation of interest rates under the LIBOR in 2011.

From his base in Chicago, Sandor and his team travelled over the US, hoping to convince regional banks to use the AFX. With time, the AFX has grown to also service broker-dealers, insurance companies, private equity firms, hedge funds, Futures Commission Merchants (FCMs), asset managers, and finance companies.⁶²

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55. Six Group, 'SARON - Swiss Average Rate Overnight: The New Swiss Franc Benchmark' <https://www.six-group.com/dam/download/sites/exchange-services/Factsheets/saron_factsheet_en.pdf> accessed 5 June 2020.
56. Adam Samson & Sarah Provan, 'Swiss National Bank announces Policy Rate to Replace LIBOR' *Financial Times* (2019) <<https://www.ft.com/content/e6477c30-8da7-11e9-a1c1-51bf8f989972>> accessed 5 June 2020.
57. Ernst & Young (n 52).
58. Thomas J Jordan, 'SARON- An Innovation for the Financial Markets' (*Swiss National Bank*, 2009) 2 <https://www.snb.ch/en/mmr/speeches/id/ref_20090825_tjn_1/source/ref_20090825_tjn_1.en.pdf> accessed 5 June 2020.
59. *ibid.*
60. Charles Gates, 'The Case for Ameribor' (*Global Financial Markets Institute*, 20 May 2019) <<https://www.gfmi.com/the-case-for-ameribor/>> accessed 5 June 2020.
61. Mark Melin, 'Regulators Warn not to Continue with LIBOR, Richard Sandor sees a Future with Multiple Interest Rates Benchmarks' (*Futures*, 25 July 2019) <<http://www.futuresmag.com/2019/07/25/regulators-warn-not-continue-libor-richard-sandor-sees-future-multiple-interest-rate>> accessed 5 June 2020.
62. *ibid.*



LOAN MARKET ASSOCIATION (LMA) RESPONSE TO LIBOR REFERENCE RATE SELECTION AGREEMENT

The LMA, in conjunction with the international law firm, Clifford Chance, prepared a draft Reference Rate Selection Agreement (the "Agreement") premised on the fact that legacy loan documentation may need to be amended when LIBOR ceases to be published by 2021.⁶³ The Agreement will allow parties, under an existing LIBOR based loan documentation, to agree on the applicable alternative reference rate(s) which will be used to calculate interest under that facility agreement and other terms which will need to be amended or determined consequently.⁶⁴

Some of the key provisions of the Agreement are:

Scope of Amendments

On the Effective Date, the Original Facility Agreement shall be amended and supplemented utilising the Amendment Agreement in order that an applicable Alternative Reference Rate applies in place of each applicable Existing Reference Rate including, without limitation, any amendment or supplement which relates to:

- a. aligning any provision of any Finance Document to the use of any Alternative Reference Rate;
- b. enabling any Alternative Reference Rate to be used for the calculation of interest under the Original Facility Agreement (including, without limitation, any consequential changes required to enable that Alternative Reference Rate to be used for such purpose);
- c. implementing market conventions applicable to that Alternative Reference Rate;
- d. providing for appropriate fallback (and market disruption) provisions for that Alternative Reference Rate;
- e. adjusting the pricing to reduce or eliminate, to the extent reasonably practicable, any transfer of economic value from one Party to another as a result of the application of that Alternative Reference Rate; and
- f. implementing the terms agreed in this Agreement.

Terms of Amendments

Other than as set out in the Selection Sheet, the amendments and supplements referred to in paragraph 1 (Scope of amendments) above shall, in relation to the use of an Alternative Reference Rate(s) for a currency include the incorporation of terms which are substantially similar to and consistent with those terms which relate to the use of that Alternative Reference Rate(s) for that currency contained in the applicable LMA Reference Agreement.⁶⁵

With this LMA Reference Agreement which will be made part of the LMA suite of documents for loan transactions, financial institutions such as Nigerian banks will begin to have the conversation on which alternative reference rate to apply to their loan documents. This Agreement will also

63. Loan Market Association, 'LIBOR' <<https://www.lma.eu.com/libor/documents>> accessed 5 June 2020.

64. Loan Market Association Reference Rate Agreement <https://www.lma.eu.com/application/files/8415/7925/5873/Exposure_draft_of_reference_rate_selection_agreement_for_transition_of_legacy_transactions_to_risk-free_rates.docx> accessed 5 June 2020.

65. *ibid.*



provide guidance on how best to deal with the historical loan document, which was prepared using the LIBOR rates as the benchmark rate. Currently, some local banks have weighed in on the LIBOR conversation since most financial transactions are being restructured in line with the Central Bank of Nigeria's directive on the COVID-19 pandemic.⁶⁶ This, therefore, presents a perfect opportunity for the banks to address issues surrounding the benchmark for their interest rates.

CONCLUSION

With the global shift from LIBOR and its proposed phasing out in 2021, the question to the Nigerian financial institution becomes, which alternative reference rate will be used in loan documentation? It is easy to speculate that where the currency of the transaction is the Nigerian Naira, the reference rate will remain the NIBOR as there is no other alternative rate for benchmarking interest rates for Naira denominated transaction. The alternative reference rate to be relied on by Nigerian banks may depend on the foreign counterparties to the transaction.

With LIBOR, Nigerian banks could rely on its rates without examining if the rate is favourable to them. The advent of alternative reference rates implies that the local banks will be forced to review the various reference rates in order to determine the applicable rate. In addition, the LMA Reference Rate Selection Agreement offers the lending banks an avenue to amend existing loan facilities to select an alternative reference rate for their documentation. It would, therefore, be advisable for Nigerian banks to take advantage of the flexibilities offered by the LMA Reference Rate Selection Agreement and proactively work to amend existing loan facilities before LIBOR is phased out.

66. Central Bank of Nigeria, 'Circular to Deposit Money Banks and the General Public on CBN Policy Measures in response to COVID-19 outbreak and Spillovers' (CBN, FIR/DIR/GEN/CIR/07/049, 16 March 2020).
<<https://www.cbn.gov.ng/Out/2020/FPRD/CBN%20POLICY%20MEASURES%20IN%20RESPONSE%20TO%20COVID-19%20OUTBREAK%20AND%20SPILLOVERS.pdf>> accessed 19 June 2020.

