THE RISE IN LIBOR

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Executive Summary

- The rise in LIBOR in early 2018 is a function of technical external factors and   a sign of stress in the financial markets
- No immediate impact on the credit quality of insurer

What is LIBOR?

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The interest rate which banks offer to lend money to one another on a short-term basis in the Eurodollar market

Applications of LIBOR

- Primary benchmark for short-term

LIBOR Reform

Markets expected to transition away from LIBOR due to price manipulation concerns that came to light in 2012

- U.K. – Financial Conduct Authority (Britain's primary financial regulator) will stop requiring banks to provide quotes used to calculate LIBOR by the end of 2021
- U.S. – Testing alternative rate based on the cost of overnight loans, or repurchase agreements
  - Secured Overnight Financing Rate (SOFR) launched in April 2018
  - Transition will be gradual and complicated

LIBOR Spikes in 2018

- Steady and gradual increase in 2016 and 2017
- Rise accelerated in 2018, climbing to 2.37% in early May
- Highest level since October 2008 but still over 200 bps lower than the las peak

Why Did LIBOR Spike?

During Financial Crisis…

Lack of trust between banks leads to reluctance to lend to one another

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Stress in banking sector

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Capital markets (money markets in particular) froze

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No market liquidity

Today…

Corporate tax reform

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Increase in short-term U.S. Government debt issuance

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Unwinding of the Fed's balance sheet

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Market liquidity unaffected by these technical factors

Technical Factors Lead to Rise in LIBOR

- Eliminates incentive to keep dollars offshore
- Decreases the supply of dollars for short-term lending in the Eurodollar market, driving LIBOR higher

Useful Links

- ICE LIBOR
- LIBOR FAQs
- Oliver Wyman Report on LIBOR Transition