To: The Wheatley Libor Review
From: David W. Clark, (member of the BBA/Oliver Wyman Review Supervisory Committee)

1. I am writing this reply in a personal capacity. I am Chairman of the Wholesale Market Brokers Association (WMBA), and its sister association the London Energy Brokers Association (LEBA), and am a NED on the boards of Tullett Prebon, and of Westpac Europe Ltd. These entities are, or may be, making replies on their own behalf, but I wish to comment from my own experience in the markets and of having participated in the Supervisory Committee.
2. I do not wish to answer each consultation question (that will have been done through other submissions that I have been involved in) rather I wish to propose a radical solution in respect of rebuilding the unsecured interbank deposit market. I appreciate that this may be outside the remit of the Review.
3. *(For the record, I do not entirely agree with the analysis of the issues and failings of LIBOR (Chapter 2). For example, LIBOR dates back to the early 1970's and earlier in respect of syndicated lending. This is important because the use and importance of LIBOR as a funding benchmark for retail (SME) borrowers as well as for corporate and capital market activities has been understated. LIBOR's link to derivative markets came much later in the 1980's and in retrospect undermined LIBOR in a way that we could not then grasp.*
4. *(Similarly, I do not think that Chapters 3,4 and 5 despite the well posed questions deriving from them, draw out two essential requirements for market benchmarks going forward:*

(I) the need for a real funding benchmark that can be trusted and relevant to borrowers in all sections in the economy and which reflects the cost of funds to the lenders;
(ii) a benchmark pricing and revaluation curve for all other derivative and off-balance sheet exposures.

5. I therefore suggest that two benchmark curves are required. In respect of 4. (ii) above, the calculation of a curve can be achieved by using one, or preferably more, of a number of derivative or off-balance sheet products which can be evidenced by actual trades calculated on a Value Weighted Average basis to provide maximum transparency with negligible scope for manipulation. A composite curve would be preferable and users would be able to adjust revaluations for basis risk using accepted model analysis.
6. The real dilemma arises with the objective of 4.(i) above. The Oliver Wyman analysis of actual trades done in different time buckets makes it clear that the volume and number of transactions is not statistically significant across the maturities fixed, and the resulting rates do not represent a true cost of funding which would be reliable enough for those needing a funding benchmark. The inescapable reason for this is the demise, between Q2 2007 and Q2 2008, of the unsecured interbank market. Prior to this period, LIBOR was a functioning funding benchmark, and its correlation with derivative curves validated LIBOR for both pricing and revaluation purposes until liquidity and implied credit spreads ceased to make it meaningful.
7. It is unlikely that, in present market conditions and in the current regulatory climate, banks will be willing support an unsecured interbank market. Synthesising LIBOR using other products and/or using expert judgement is technically feasible but would not reflect a funding rate. Fixing a LIBOR rate in this environment becomes impossible.
8. Reviving the Interbank market has not been considered to be possible, but only if it is achieved will LIBOR have any meaning in respect of a funding benchmark. I do not believe that enough consideration has been given to this possibility, and it is not clear

where the responsibility would lie to consider or implement it. (In previous times of severe stress or market dislocation, such as in 1973 and 1990, the Bank of England intervened to encourage the maintenance of the interbank market, but this is not a policy 'tool' a such).

9. Clearly banks would need to be incentivised to participate again in an unsecured interbank market. I suggest that those incentives exist in the way in which bank' s liquidity and capital ratios are regulated. This reply cannot address detail, but areas for possible regulatory and supervisory intervention that might help to revive interbank activity include:

    a. reviewing how the proposed Liquidity Coverage Ratio (LCR, Basel III) is implemented. The ratios proposed as well as the stress testing could be calibrated to favour unsecured interbank assets and liabilities, with banks having to 'elect' to participate. Banks doing so might also have the assets and liabilities ' ring fenced' possibly to coincide with Vickers requirements. Other variables that may be used include:
    b. Intra 30 day cash flow gaps; review of Level 1 and Level 2 assets and their risk profile; cash inflow and outflow weightings and haircuts; capital weighting of interbank assets; the liquidity buffer framework;
    c. use of ICAAP and ILAA and the ICG to incentivise interbank lending and deposit taking (using Pillar 2 discretion).

10. If volumes created by such measures were statistically significant, the way in which LIBOR is fixed should change. Traded data over a London working day (say, 08.00 - 17.00) would be collected, possibly through a trade repository, and averages calculated on a value weighted basis. Snapshot fixings could take place (at 11.00 and possibly 15.00 for Sterling) calculated on the same basis. The curve created would inform borrowers of their banks cost of funds and not be subject to distortion by the inclusion of derivative products. Data input would be transparent and no single bank would be in a position to manipulate data.
11. A LIBOR Code of Conduct might not be necessary in this structure (other than for internal bank use), but data integrity, calculation methods and data distribution would need to be governed by rules.
12. Over time, the two benchmark curves would adopt a correlation based on liquidity, credit spread and volatility which the market could then use for different on- and off-balance sheet exposures and products.
13. This reply does not address past issues relating to manipulation or market abuse, or the suitability of certain products being fixed on LIBOR. These have been addressed in other replies. It seeks to offer for consideration a possible way of reviving the interbank market without which LIBOR would have little relevance.
14. I would be happy to elaborate on or discuss any point in the above reply that you might find worthwhile.

David W, Clark
[redacted]

The European Association of Corporate Treasurers

Comments in response to the 'Wheatley Review of LIBOR' – initial discussion paper

Issued by the UK Government, August 2012

The European Association of Corporate Treasurers (EACT)

The EACT is a grouping of 20 national associations representing treasury and finance professionals in 17 countries of the European Union. We bring together over 11,000 members employed in more than 6,000 companies located in the EU. We comment to the European authorities, national governments, regulators and standard-setters on issues faced by treasury and finance professionals across Europe. We seek to encourage the profession of treasury, corporate finance and risk management, promoting the value of treasury skills through best practice and education.

Our contact details are provided on the final page of this document.

1 – Our approach

The EACT is limiting its brief response to the initial discussion paper (IDP) to the failings of LIBOR, the case for change and the importance of continuity. We reference our comments to the relevant chapter and questions in the IDP.

2 – The failings of LIBOR and the need for change

[Chapter 2, Q.2.1] The EACT broadly agrees with the main thrust of the analysis.

[Chapter 3, Q.3.4 – Q.3.6] The EACT considers that there are significant weaknesses in the current governance arrangements and stresses the following:

- it is inappropriate that LIBOR should be in the hands of a trade association, the British Bankers Association. We consider that an appropriate authority (whether the FSA or the Bank of England) should be responsible for the LIBOR setting process [Q.3.4 and Q.3.7];
- we support the view that setting of and/or submission to LIBOR should be regulated activities [Q.3.5]; and
- there should be the potential for legal investigation and action in the event that there is attempted or actual manipulation of LIBOR [Q.3.6].

[Chapter 3, Q.3.4] In the event that future oversight arrangements are proposed to include representation for non-financial end users – the corporate customers of the banks – the EACT would encourage consideration of inclusion of the EACT (or the UK treasury association, the ACT) in such a governance structure.

3 – The existence of alternatives and the need for continuity

[Chapter 4, Q.4.1] We are not aware of any credible alternative benchmarks that could immediately replace LIBOR's role in the financial markets. There is however a measure of support from treasurers for overnight index swaps (OIS) as an alternative; we hope that this can be taken into account by this review and further work done as appropriate.

[Chapter 4, Q.4.4] The comment above makes it particularly important that any move to introduce an alternative to LIBOR recognises the need to allow for continuity in old contracts. This could be straightforward if the 'improved' LIBOR fitted within existing contractual definitions: the issue becomes much more complex if the proposal was to introduce an altogether 'new' LIBOR. In that situation the interests of non-financial end users with borrowing contracts geared to LIBOR pricing must be protected to avoid a transfer of value from borrowers to lenders.

The European Association of Corporate Treasurers

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Introduction

EBRD was created in 1991 to support the development of market economies in central and Eastern Europe following the widespread collapse of communist regimes. We lend to, and invest in, primarily private sector clients whose needs cannot be fully met by the market. Our banking business is supported by a Euro 47 bio balance sheet (as at 31/12/2011), which we manage on a floating rate basis across a wide range of currencies and benchmarks. EBRD is thus a major user of LIBOR and other interbank indices, both via its cash and derivative books. As such, we have been directly exposed to the dislocation of the markets since the onset of the crisis and in particular to LIBOR and other interbank indices.

The EBRD's mandate goes beyond traditional banking activities. The transition process from command economies to open market economies requires an enormous range of structural transformation. One of them is the development of domestic money and capital markets to support the domestic economy. EBRD has been actively promoting the development of domestic capital markets and in particular of reliable domestic interbank benchmarks, which are a pillar to the development of efficient domestic markets.

As such, we would like to take the opportunity of the 'Wheatley Review of LIBOR' (the 'Review') to share the lessons we have learnt both as a market participant directly impacted by the fundamental changes that have occurred in the wholesale money markets since the beginning of the crisis and as an advisor to the reforms of interbank benchmarks used in some of our Countries of Operations.

As a user of LIBOR, the main point we would like to convey in this note is that an index reflecting unsecured interbank funding levels can no longer perform on its own the multifaceted role LIBOR has been playing as a single benchmark used for loans, bonds and derivatives. A single index will always struggle to effectively fulfil many functions at once, particularly when its underlying market is dying out.

As an advisor to the reform of the interbank indices in several other markets, we would like to share some of the lessons we have learnt through our experiences. Oddly enough, the experience from some emerging markets can indeed be relevant for the purpose of the LIBOR Review, as G10 unsecured interbank markets now share some of the features which had traditionally characterised emerging markets only (e.g. the low transaction volume concentrated in the shorter tenors).

In this note, we do not answer to the all the Consultation questions, but prefer to focus on the points we deem most relevant.

Issues and failings with LIBOR

Whilst we agree with most of the analysis of the issues with LIBOR as outlined in the Review, we would like to highlight a few points:

LIBOR is trying to serve too many purposes

The Review outlines the fact that LIBOR is used by a wide variety of participants for a wide variety of transactions. The Review fails, however, to articulate that one of the major problems with LIBOR is that it no longer is a clean gauge of money market interest rate expectations linked to central bank policy rates. The majority of contracts linked to Libor, interest rate derivatives, were linked to Libor as a reflector of interest rate expectations. The users of the instrument were not linking it to Libor for the purpose of capturing the price of liquidity or the 'price of risk' of the banking system. The fundamental reshaping of the money markets since the crisis introduced elements into the setting of Libor that the majority of its uses were not designed for.

LIBOR was acceptable as a single benchmark until the onset of the crisis, when its pricing started to embed the 'real' cost of liquidity, the credit risk of the individual bank, and the generic level of bank credit risk. The ability to see direct pricing of bank credit risk through the individual submissions became a focus and started to have a deleterious effect on the stability of the financial system. The increase in the perceived bank credit risk was reflected bya sharp fall in both the maturity and overall volumes of unsecured money market business, which in turn created further difficulties in assessing what the actual LIBOR rate is or should be.

The move to embed pricing of the counterparty and liquidity risk in unsecured interbank transactions not only induced a sharp reduction in interbank lending (thereby introducing the need for expert judgment in LIBOR contributions, at least for the longer dated points), it also introduced an additional risk element in Libor. As a result, it became difficult to manage exposures purely related to interest rate expectations through LIBOR. In reaction to the crisis, a new basis risk for market players was introduced: the spread between Libor and Overnight Index Swaps ('OIS'). For example, players wanting to hedge interest rate risk via Interest Rate Swaps may not want to be exposed to volatility in the interbank credit and liquidity premium. The latter could be managed independently. Similarly, floating rate investors or issuers may prefer to reference their assets or liabilities to a pure interest rate index plus a separate spread reflecting the credit and liquidity risk of each individual issuer. Referring to a pure interest rate index stripped from credit considerations would remove the credit-signalling risk faced by contributors under the current LIBOR mechanism and would thus reduce the risks/incentive of index manipulation.

According to Table 2.A of the report, Interest Rate Swaps represent more than half of the transactions indexed to LIBOR. Introducing a new index which would reflect pure interest rate risk expectations could benefit a very large share of the market. And as mentioned previously, investors, borrowers and issuers might be more interested in referencing their assets or liabilities to an index that is 'constant' in its behaviour, i.e. reflecting a single factor. In addition, issuers will or should be prepared to pay a separate premium reflecting both the cost of term liquidity and the credit risk associated with them as a borrower.

There are actually too many contributing banks

We agree that there is currently 'a large dispersion in the perceived creditworthiness of banks' (2.17) and that 'the concept of an average interbank-rate derived from a panel of diverse banks has less meaning as a measure of bank funding costs'. The latter is not so much the result of the 'low volume of interbank unsecured transactions' as mentioned in the note, but more because of the wide variety of credit ratings of the contributing banks. Contrary to what is suggested in the analysis, we believe that the existing panels are actually too large (the last bullet point of 2.24 states that the existing LIBOR panels are relatively small). Our experience in reforming existing indices in emerging markets shows that participants actually want to see an index reflecting the cost of funds of banks with similar credit ratings. Individual market players want to be able to price specific risks versus a transparent and simple index. An index reflecting the average banking premium for a specific market is much less transparent than an index reflecting the credit and liquidity premium for prime banks only.

Strengthening LIBOR

As we mention in the introduction, EBRD has worked for years with market participants in some of its Countries of Operations on various options to strengthen their domestic interbank indices. Of all the options suggested in Chapter 3 of the Review, ***supporting contributors in submitting rates, narrowing the coverage of an index to shorter maturities*** (to the most actively traded ones) and ***strengthening the governance and oversight*** (generally via a clear disciplinary mechanism) were the most widely supported. In our view, the other options are either ones that would weaken or have no impact on LIBOR for the following reasons:

- Corroborating individual submissions would be extremely difficult in most cases and inefficient if the market wants a real time fixing.

- Changing the calculation methodology to the median methodology might reduce vulnerability to manipulation, but might not help improve the index credibility if the new methodology is applied to a wide panel of contributing banks with different credit ratings. As mentioned previously, we believe that widening the panel of contributing banks would actually weaken LIBOR.

- Ceasing the publication of individual submissions would remove the credit-signalling effect of the current mechanism and might therefore indeed reduce banks' incentive to contribute rates lower than those at which they would really fund themselves. It would however make the rate setting mechanism less transparent, which might actually weaken LIBOR. Delaying the publication would not make banks feel more comfortable with publishing the actual rate at which they would fund in the inter-bank market, as a delayed rates publication would not remove the credit-signalling effect of the contribution.

This latter credit-signalling issue highlights why, from a financial stability perspective, publishing individual bank funding rates has become dangerous and self-defeating and hence markets ought to move to a new rate setting mechanism, free of such credit-signalling element.

- Amending the question asked to that of 'the rate which participating banks think would be offered by one prime bank to another' is too subjective and thus also open to manipulation.

- Increasing the number of contributing banks would actually weaken LIBOR, as mentioned previously.

Back to the first suggestion on ***supporting contributors in submitting rates***. While we agree that referring to actually traded transactions (as suggested in point 3.4) could in theory strengthen LIBOR, we do think that referring to actually traded rates would only be possible under a new index definition. A fixing on actually traded rates would indeed generally reflect rates traded over a specific period of time (generally over a one-day period), as opposed to the existing real-time LIBOR fixing mechanism. This would be a significant change in the index fixing mechanism, which should only be acceptable under a new index.

The only way to address the issue of lack of underlying transactions for a real-time fixing index is to make the contributions binding for a pre-agreed minimum trade size and for a specific period of time (e.g. 30 minutes after submitting the contributing quotes). This mechanism however, raises the issue of interbank credit lines. Various markets in our countries of operations have adopted this binding mechanism, but have capped the exposure banks have to commit to potentially take when contributing to the index. As a result, the contributions are generally only binding for relatively small trades. Although this implies that the volume of actual transactions underlying the index may still be thin, the process does actually help strengthen the indices.

Thin underlying transaction volumes may give sufficient credibility to indices used as benchmark in small markets. In that context, there are indeed only small incentives to manipulate the index. In larger markets, the size of underlying transactions needs to be large enough to reduce the risk of manipulation and thereby allow for the strengthening of the index.

In practice, contributing banks may only accept to commit to trade larger sizes at their contributed rates if the trades are collateralised trades (either as repo or via a CCP). This however, would be a different instrument priced differently from unsecured interbank transactions, and would thus again imply the creation of an alternative index as opposed to strengthening LIBOR.

In any case, we believe that ***strengthening governance and oversight*** is necessary and should definitely improve the index credibility, as this would remove the perception that rates can be manipulated with impunity. Most of the countries we have been working with have adopted a disciplinary mechanism allowing for the exclusion from the contributing panel banks who fail to comply with the fixing rules. Committing to trade at the contributed rates might indeed not be sufficient to restore the index credibility if the committed trade size is too small. It thus needs to be supplemented by a formal process to remove contributing banks from the panel if they don't meet pre-agreed criteria.

Finally, when reviewing options for ***improving the regulatory oversight and strengthening the criminal sanction regime***, regulators should bear in mind that they need to find the fine balance that will strengthen the index without discouraging contributing banks from participating in the panel. Making the LIBOR contribution compulsory is not the solution either as it would widen the number of contributing banks, which as we mentioned earlier, would actually most probably weaken the index.

Alternatives to LIBOR

As previously mentioned in this note, we believe that LIBOR, in its current format and in the new market landscape, is trying to serve too many purposes and that the market needs to develop and adopt new indices more relevant for specific segments of the market.

LIBOR needs to be maintained at least until all outstanding transactions indexed to it have expired. It can easily co-exist with alternative fixings though.

We mentioned earlier that LIBOR is now including a wide and volatile (banking) credit and liquidity premium. This makes LIBOR less relevant for some specific instruments which have traditionally been using LIBOR as a benchmark. This is particularly the case of interest rate derivatives. Market players wanting to hedge pure interest rate risks should be interested in an index reflecting pure interest rate expectations. LIBOR versus OIS spreads has emerged as a new risk factor, and this exposure must be managed. Several market participants have already adopted the OIS curve as the risk-free curve to discount their Interest Rate Swaps, but it will take a while until the market as a whole gravitates toward a standard OIS discounting curve. Indexing Interest Rate Swaps to an OIS fixing would make full sense.

In the case of Euro, the OIS fixing already exists (€ONIA swap index), but is not used by market participants. This may be because there is a liquid Eonia futures market and the market has not seen thus far the need for an alternative fixing for OTC derivative transactions.

Similarly, the cash market could also benefit from using an OIS fixing as a benchmark for its floating rate products. Interest rates on assets would then move from being referenced to LIBOR plus a credit spread reflecting the borrower's 'excess' credit and liquidity risk to the average interbank credit risk to being referenced to an OIS fixing plus a different credit spread reflecting the full borrower's credit and liquidity risk. The latter spread would be wider than the former spread, but the all-in interest rate, being more transparent, could be lower and would better reflect individual borrowers' credit and liquidity risk. It would also allow to fix the credit/liquidity spread for the life of the asset, as opposed to being exposed to volatility in the average banking spread which would be reset on each interest payment date – as is currently the case for LIBOR indexed assets.

We believe that an OIS fixing would currently be the alternative index which would benefit most segments of the market. Unlike LIBOR, it would not become a benchmark used indiscriminately for very different transactions: being a pure reflection of interest rate expectations, it can be used (flat) as the underlying benchmark for interest rate swaps and supplemented by a more transparent credit spread for cash instruments. Also, such an index would address the credit-signalling risk embedded in the current LIBOR definition and thereby reduce the incentives individual contributors may have to manipulate their rates.

The other candidate benchmarks suggested in the LIBOR Review are either inappropriate for the role of benchmarks for large developed markets (e.g. Central Bank policy rate), or reintroduce some credit spread element (e.g. CDs and Tbills) or are mainly traded in shorter tenors (e.g. repos). Some of them may however still become used by some specific market segments.

Whilst markets will decide on which index(es) they need most and will largely drive the speed at which new indices will be introduced and adopted, the regulators could guide the process by promoting the indices they think would best benefit the markets. Central banks can also help in computing transparent indices, by using their infrastructure to monitor traded transactions. Putting their stamp of approval on a new fixing would certainly help markets gain confidence in the process.

Potential implications for other benchmarks – EBRD's experience in Russia

The issues listed in the Review are not new and are actually applicable to most other unsecured interbank indices across the world. Unsecured interbank money markets are dying across the world and all markets relying on indices similar to LIBOR should rethink those indices and consider introducing new ones. Some markets have actually already done some work on this and implemented some of the reforms proposed in the Review.

Ironically, reaching an agreement on how to strengthen and/or replace an index and implementing the agreed changes may be easier in smaller markets with fewer outstanding transactions referenced to the existing unsecured benchmark. The enormous volume of outstanding transactions referenced to LIBOR, the wide variety of stakeholders with differing interests and the natural resulting inertia of the reform process do not help enforcing reform measures.

To that extent, the work done in Russia on the indices is a good example.

With exactly the same issues in mind (as those highlighted in the case of LIBOR), the EBRD has been actively working in Russia and Turkey to promote further changes to benchmark money market reference rates. Having been instrumental in the creation and refinements of Mosprime in Russia, the EBRD concluded that in the aftermath of the 2008 crisis the Russian markets required an index that was a truer and more stable reflection of pure domestic rate expectations. The first step was to create an overnight index, akin to Fed Funds in the US and Eonia in the EZ. The Central Bank of Russia launched the official calculation of Ruonia (the Russian Overnight RUB Index) in September 2010, quickly followed by the first Overnight Index Swap concluded by the EBRD and a market counterparty. In conjunction with the NFEA (National Foreign Exchange Association of Russia) and its index committee we set up a fixing framework for the Russian OIS index: ROISfix, which launched in April 2011. To further encourage the use of this index EBRD has approved its first loan linked to ROISfix and is looking to issue a bond linked to it in the near future. Ultimately we hope to replace Mosprime, with ROISfix accepted as the floating rate index for all Rouble interest rate derivatives, and create a consistent framework for interest rate products that is reflective of interest rate expectations only.

Conclusion

Our work in Russia is a practical illustration of our views on the questions raised in the Wheatley Review of LIBOR.

In summary, we believe that a stronger LIBOR should co-exist (at least over the transition period, which could last until all LIBOR outstanding transactions have matured) with other indices. In particular, we would recommend a wider use of OIS by market participants and the creation of an OIS fixing in markets where it does not already exist. The latter, as a pure reflection of interest rate expectations, could become the new benchmark for most products. Stripping the credit and liquidity spread from the benchmark, would improve market transparency, remove both the volatility induced by the credit/liquidity spread from the benchmark and the credit-signalling stigma risk embedded in the current LIBOR definition. This new index definition, provided it comes with stronger governance and oversight, would thus remove most incentive contributing banks may have had to manipulate their rates.

Finally, an OIS fixing, by improving transparency in markets' expectations on interest rates, would improve the monetary policy transmission mechanism. The latter would highly benefit markets that are currently under scrutiny for a broken monetary policy transmission mechanism.

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The Wheatley Review
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7 September 2012

Dear Sirs

The Wheatley Review of LIBOR

F&C Asset Management plc ("F&C") is a leading diversified investment management group. As at 30 June 2012 we managed £98.2 billion of assets and our sole activity is asset management. Our clients comprise a wide range of institutional, insurance, pension and retail investors, across multiple jurisdictions and we manage a diverse spread of investments including equities, fixed income, UCITS and non-UCITS funds, investment companies, property and other alternative asset classes including hedge funds, funds of hedge funds, private equity and funds of private equity funds.

We are grateful for the opportunity to comment on this review and we are generally supportive of the comments and proposals in the paper. We also support the comments made by the UK's Investment Management Association on behalf of their members. Our specific response to the questions raised are contained in Appendix I.

If we can be of further assistance, please do not hesitate to contact us.

Yours sincerely

Philippa Hall
Head of Regulatory Strategy

Appendix I Response to consultation questions

F&C Investments

APPENDIX II – Response to consultation questions

Chapter 2: Issues and failings with LIBOR

Do you agree with our analysis of the issues and failings of LIBOR?
Generally Yes.

Chapter 3: Strengthening LIBOR

Can LIBOR be strengthened is such a way that it can remain a credible benchmark?
Yes we believe it can.

Could a hybrid methodology for calculating LIBOR work effectively?
No comments.

Could the number of maturities and currencies currently covered by the LIBOR benchmark be reduced?
Yes we believe there is some scope to reduce.

Is an alternative governance body for LIBOR required in the short term?
Given that the LIBOR scandal has caused significant reputational damage to the London Market appointing a governance body in the short term would demonstate that the UK is taking appropriate action particularly given that revisions to the European Market Abuse Regime are unlikely to come into effect before 2015.

Should the setting of and/or the submission to LIBOR be regulated activities?
Yes.

Should the regulator be provided with specific powers of criminal investigation and prosecution in relation to attempted manipulation and manipulation of LIBOR?
Strengthening the governance arrangements, extending regulated activities to include the provision of data to and the setting of a benchmark and extending the approved persons regime to cover LIBOR-setting related activities should be sufficient to prevent attempted manipulation and manipulation of LIBOR. We are not convinced it is necessary for the regulator to be granted specific powers of criminal investigation and prosecution at this point in time.

What role should authorities play in reforming the mechanism and governance of LIBOR?
Regulators should satisfy themselves that the mechanism and governance of LIBOR is robust. The mechanism and governance should be subject to ongoing scrutiny and review. Those responsible for calculating the rate should be required to error report.

Which types of financial contract, if any, would be particularly affected by the risks of a transition from LIBOR?

There are many types of financial contract that would be affected by the risks of a transition from LIBOR and any move to an alternative could also be prone to attempted or actual manipulation unless similar governance arrangements are applied to the alternative. Any transition is likely to be problematic, time consuming and costly given the number of contracts in existence. A key concern would be to ensure that existing contracts are not frustrated. Any impact on pricing models of instruments based on LIBOR would also need to be considered as would the cost of revised disclosure which again could be significant. Any move to one or a number of alternatives could lead to market fragmentation. We assume that any move to an alternative would be for future contracts and not for existing ones.

Chapter 4: Alternatives to LIBOR

Are there credible alternative benchmarks that could replace LIBOR's role in the financial markets?
Yes possibly e.g. SONIA.

Should an alternative benchmark fully replace LIBOR, or should it substitute for LIBOR in particular circumstances?
Our preference is not to replace LIBOR.

Should particular benchmarks be mandated for specific activities?
No.

Over what time period could an alternative to LIBOR be introduced?
Our preference is not to move to an alternative.

What role should authorities play in developing and promoting alternatives to LIBOR?
No Comments.

Chapter 5: Potential implications on other benchmarks

Are there other important markets or benchmarks that could face similar issues to those identified relating to LIBOR?
No Comments.

Should there be an overarching framework for key international reference rates?
There are several different bodies looking at benchmarks generally and it would be helpful if this was coordinated at an international level to avoid a patchwork of regulation that we are seeing with other proposals.

Finance & Leasing Association

THE WHEATLEY REVIEW OF LIBOR: INITIAL DISCUSSION PAPER

VIEWS FROM THE FINANCE & LEASING ASSOCIATION

SEPTEMBER 2012

Introduction

1. The Finance & Leasing Association (FLA) is the leading trade association for the consumer credit, motor finance and asset finance sectors. Our members include banks and building societies and their subsidiaries, the finance arms of leading retailers and manufacturing companies and a range of independent firms.

2. In 2011, FLA members provided £73 billion of new finance to UK businesses and households. £52 billion was provided to consumers, which represented 30% of consumer credit written in the UK last year. New business written by FLA consumer finance providers was made available via credit and store cards, unsecured loans, store instalment credit, second charge mortgages and dealer motor finance. 64% of private new cars sales were bought using dealer motor finance. The remaining £21 billion was provided to small and medium sized enterprises, corporates and the public sector, primarily via leasing and hire purchase. This represented more than a quarter of UK fixed capital investment (other than property and own-account software).

3. At the end of July 2012, the value of outstanding contracts written by FLA members was £132.1 billion. The value of outstanding business finance contracts was £67.2 billion, which included £6.7 billion of outstanding dealer support finance. The corresponding number of outstanding business finance contracts (including dealer support) was 2.2 million. The value of outstanding consumer finance contracts was £64.9 billion and the corresponding number of outstanding consumer finance contracts was 30.5 million.

4. FLA members have hundreds of thousands of outstanding finance contracts, which are linked to LIBOR either directly or indirectly through the Finance House Base Rate (FHBR)[1]. Replacing LIBOR would lead to these contracts having to be renegotiated, at significant cost to the industry.

[1] The Finance House Base Rate (FHBR) is calculated by the FLA on the last Friday of each month and the resulting figure becomes effective from the first day of the following month. The rate is calculated at the end of each month by averaging the cost of three-month money in the interbank market over the previous eight weeks.

Chapter 2: Issues and failings with LIBOR

Do you agree with our analysis of the issues and failings of LIBOR?

5. The FLA's concern is that any changes to the current system do not involve unintended and unnecessary costs for lenders currently using LIBOR to set interest rates.

Chapter 3: Strengthening LIBOR

Can LIBOR be strengthened in such a way that it can remain a credible benchmark?

6. The FLA would support initiatives to strengthen LIBOR because, in spite of the fall in the number of real transactions on which submissions are based, it remains one of the few published rates that make reference to real money costs.

Could a hybrid methodology for calculating LIBOR work effectively?

7. The FLA supports the Review's view that if a hybrid methodology for calculating LIBOR were introduced and it involved a change in definition, then the introduction of the new methodology would have to be managed so that existing LIBOR-referenced contracts were not invalidated (3.13).

Could the number of maturities and currencies currently covered by the LIBOR benchmark be reduced?

8. As mentioned in point 6, the FLA would support initiatives to strengthen LIBOR, but existing LIBOR-referenced contracts should not be invalidated as part of that strengthening process. This might occur if the number of maturities and currencies currently covered by LIBOR were to be reduced.

Is an alternative governance body for LIBOR required in the short term?

9. The FLA does not see this as a pressing issue.

Should the setting of and/or the submission to LIBOR be regulated activities?

10. As mentioned in point 6, the FLA supports initiatives to strengthen LIBOR which would reduce the need for the setting or submission of LIBOR to become regulated activities.

Should the regulator be provided with specific powers of criminal investigation and prosecution in relation to attempted manipulation and manipulation of LIBOR?

11. The FLA does not have a particular view.

The resulting figure is then rounded up to the next half point. The process is entirely arithmetical and contains no discretionary element. Further details may be found at www.fla.org.uk.

What role should authorities play in reforming the mechanism and governance of LIBOR?

12. The meaning of this question is not clear.

Which types of financial contract, if any, would be particularly affected by the risks of a transition from LIBOR?

13. FLA members - in particular those providing asset finance, dealer support and second charge mortgages - have a significant number of outstanding contracts that are variable rate and linked to LIBOR either directly or indirectly via FHBR. The FLA estimates that of the 2.2 million outstanding business finance contracts at the end of July 2012, 203,000 were variable rate (9%) and 161,000 were linked to LIBOR or FHBR (7%). The number of outstanding second charge mortgage contracts at the end of July 2012 was 314,000, of which at least 227,500 were variable rate (72%) and at least 77,200 were linked to LIBOR or FHBR (25%). These contracts are term facilities, with amortisation stretching to seven years or longer in the case of structured business finance contracts and second charge mortgages. Replacing LIBOR would lead to these contracts having to be renegotiated, at significant cost to the industry. This would cause a significant amount of upheaval to both the industry and the customers it serves.

Chapter 4: Alternatives to LIBOR

Are there credible alternative benchmarks that could replace LIBOR's role in the financial markets?

14. The FLA would prefer to see LIBOR strengthened rather than replaced, because of the transitional issues mentioned in point 13. But see point 15 below.

Should an alternative benchmark fully replace LIBOR, or should it substitute for LIBOR in particular circumstances?

15. The FLA agrees with the Review that strengthening LIBOR and finding an alternative to LIBOR are not mutually exclusive options. As suggested in 2.42, changes could be made to the current framework in order to strengthen it, alongside the development of alternative benchmarks in the longer term. The key point is that existing contracts should not be invalidated, as indicated in point 7.

Should particular benchmarks be mandated for specific activities?

16. The FLA does not have a particular view.

Over what time period could an alternative to LIBOR be introduced?

17. This is difficult to say until a specific proposal has been made.

What role should authorities play in developing and promoting alternatives to LIBOR?

18. Authorities should work closely with national representative bodies of the financial service industries, such as the FLA and the British Bankers' Association (BBA) in developing and promoting any alternatives to LIBOR.

Chapter 5: Potential implications on other benchmarks

Are there other important markets or benchmarks that could face similar issues to those identified relating to LIBOR?

19. The FLA has commented from the perspective of the markets it serves.

Should there be an overarching framework for key international reference rates?

20. The FLA does not have a particular view.

The FLA would be pleased to provide further information on any of the points above.

Geraldine Kilkelly
Head of Research and Chief Economist
Finance & Leasing Association
[redacted]

Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

[redacted]

Martin Wheatley
The Wheatley Review
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

7 September 2012

Dear Martin

The Wheatley Review of LIBOR

As I outlined at our 28 August meeting, the Panel is not best placed to comment on the detailed questions posed by the Review. However, we do believe it is important to consider what effect, if any, banks' manipulation of LIBOR and other inter-bank lending rates has had on retail customers.

The Panel appreciates the Review is working to an extremely tight deadline and may not have sufficient time to consider this. However, we believe there should be a strong public commitment to investigate whether there is quantifiable evidence of consumer detriment created by the LIBOR manipulation scandal and, if such evidence is found, to take appropriate action. Given the ongoing enforcement work being undertaken by the FSA, we recognise that it might be more appropriate for it to take this forward.

Yours sincerely,

Adam Phillips
Panel Chair

The Wheatley Review
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Friday 7 September 2012

Dear Sirs

GC100 Response to The Wheatley Review of LIBOR: Initial Discussion Paper August 2012

Introduction

I write on behalf of the GC100 group in response to the above Initial Discussion Paper (DP). As you may know, the GC100 is the association for the general counsel and company secretaries of companies in the UK FTSE 100. There are currently over 120 members of the group, representing some 80 companies.

The DP covers several areas. This response concentrates on the DP's comments on strengthening the sanctions against LIBOR manipulation, particularly the suggested option of broadening the criminal offence of misleading statements and practices under s397 of the Financial Services and Markets Act 2000 (FSMA) (paragraph 3.55 of the DP). We do not comment on the specific consultation questions.

Summary

The GC100 is generally supportive of the policy objectives canvassed in the DP of making LIBOR related activities subject to regulation as FSA regulated activities and subject to criminal sanctions.

However, the GC100 strongly opposes amending s397 in the way currently suggested in the DP. It is not necessary or proportionate to substantially broaden the existing s397 offences in order to achieve the policy objectives of making LIBOR manipulation subject to criminal sanctions. Such a change could have significant adverse unintended consequences, as explained below. In the GC100's view, any proposal to amend the existing s397 offences would be a significant matter requiring full consultation and costs/benefits analysis.

There are a number of potentially more appropriate and effective alternatives that would achieve the policy objectives, such as creating a separate offence (for example a new s397A) of misleading statements and conduct specific to LIBOR. The existing s397 offences should be left unchanged.

GC100 Group
The Association of General Counsel and Company Secretaries of the FTSE 100
The GC100 Group is an unincorporated members' association administered by the Practical Law Company Limited

Secretary: Mary Mullally ▫ 19 Hatfields, London SE1 8DJ [redacted]

Section 397 FSMA

Section 397 covers misleading statements (or promises or forecasts) (s397(1)(a) and (c)), dishonest concealment of material facts (s397(1)(b)) and misleading conduct (s397(3)) undertaken for the purpose of inducing another person to take (or not take) certain action in relation to shares and other specified FSMA regulated investments and agreements, or with recklessness as to that outcome.

Section 397 contains two key mens rea components:

(a) the need for dishonesty, intention or recklessness in making the misleading statements or concealing the material facts (in the case of s397(1)); and

(b) the need to show that the statement or conduct was for the purpose of inducing behaviour by another person in relation to regulated investments (in the case of both s397(1) and s397(3)).

These requirements distinguish the s397 offence from:

(a) the civil market abuse regime, which generally focuses on the effect of the relevant conduct, rather than the subjective intention or purpose of the person responsible for the conduct (e.g. ss,118(5)-(8) FSMA). Section 397 is narrower in scope, consistent with the more severe criminal consequences attaching; and

(b) general criminal fraud offences, which do not require a connection to regulated markets or investments and are therefore not routinely the subject of investigation or prosecution by the FSA as regulator of financial markets.

Section 397 as a basis for LIBOR offences

The DP concludes that there is a gap in the existing criminal sanctions regime in relation to LIBOR. It suggests, as one option for bridging the gap, amending s397 by removing the requirement that the misleading statement or action must have been made for the purpose of inducing another person to act, i.e. removing the intention to induce element of the offence summarised in "*Section 397 FSMA*" above.

The GC100 strongly opposes amending s397 as suggested, because, as further described below, it would risk:

(a) undermining the clear connection of the offence to regulated financial instruments and markets;

(b) unintentionally criminalising behaviour beyond LIBOR manipulation;

(c) creating unnecessary legal uncertainty for business; and

(d) creating overlap with fraud offences.

Undermining the connection to regulated financial instrument and markets*:* Section 397 is essentially aimed at statements and actions which can influence investor behaviour in relation to regulated financial instruments and financial markets – for example, false profit figures which encourage an investor to buy a company's shares. Assuming that LIBOR related activities do become FSA regulated, those activities would not of themselves be done with or for investors. The effect of misdemeanours in the course of such activities would therefore be quite different in nature from those covered by the existing s397 offences, requiring a correspondingly different structure for the relevant offence. The proposed deletion of the intention to induce element to try to achieve this different structure would have the effect of removing the connection to financial instruments and financial markets for the existing s397 offences and thereby significantly widening the scope of the regime.

Widening of criminal regime: If s397 (or any subsection, such as s397(3)) is amended by simply removing the intention to induce element, then knowingly or even recklessly making a misleading statement - about anything, whether or not relating to a listed issuer or a regulated investment - could constitute a criminal offence, regardless of the intended consequences or effect. This would result in a wide range of situations that currently are not subject to criminal sanction being criminalised. The legal and regulatory framework within which companies and individuals operate has a carefully calibrated set of sanctions and remedies for misleading statements – including civil claims for malicious falsehood or defamation, statutory liability for compensation (e.g. ss90-90A FSMA), and regulatory censure and civil penalties for market abuse or breach of the DTRs. The framework deliberately limits criminal liability to those scenarios where criminal sanctions are justified – e.g. for fraudulent representations made dishonestly for the purposes of making a gain or causing a loss (see the Fraud Act 2006) or where the statement has been made knowingly and for the purposes of inducing behaviour in relation to relevant investments by a market participant. This calibrated and proportionate regime would be undermined if making a false statement was criminalised, irrespective of what the false statement related to or what effect it had.

Legal uncertainty: The core ingredients of s397 have been in place since at least 1986 (earlier for s397(1)/(2)). Business and legal advisers are familiar with the provisions and the standards expected of companies. Amendment could introduce legal uncertainty in areas of day to day business activity for a range of companies which have nothing to do with LIBOR or other benchmarks. Indeed, it is questionable whether the suggested change might be incompatible with Article 7 ECHR (retrospectivity), a point which was debated in relation to the potential introduction of a general dishonesty offence by the Law Commission in 'Fraud', 2002.

Overlap with fraud offence: If it becomes an offence merely to make a statement which is known to be misleading in a material particular, then the s397 offence will be significantly broader than the offence of fraud by false representation (s.2 of the Fraud Act 2006), which requires not only (a) knowledge that the statement is misleading, but also (b) both dishonesty, and intention to make a gain or cause a loss. The effect of amending s397 in the way that is proposed would be to render the offence of fraud by false representation largely otiose. Such a dramatic broadening of the criminal law of fraud, and the abandonment of key mens rea elements, would require a very cogent rationale. As the Home Office stated in 'Fraud Law Reform', May 2006[1], in relation to general fraud offences, "dishonesty is a necessary, though not sufficient, ingredient of any fraud"[2].

Any of these outcomes would have potentially serious practical and legal risk management implications for business. They might also be difficult to justify under the Ministry of Justice's Criminal Offences Gateway Guidance on the creation of new criminal offences, under which

[1] Introducing the draft Fraud Bill that was subsequently enacted as the Fraud Act 2006.

[2] The Law Commission consultation paper ('Fraud', 2002), which was the predecessor of 'Fraud Law Reform' referred to the misleading statements offence in the following terms: "*Similarly, the crime of employing misleading market practices is now absorbed into the new statutory framework for regulating the financial services industry, following a long consultation period between the regulator and the regulated. The aim of the consultation was to produce detailed guidance to help draw the dividing line between sharp practice and criminal practice. Given the specialist setting of these crimes, this seems to be the most appropriate way to ensure that they are fair and comprehensive*".

Secretary: Mary Mullally ▫ 19 Hatfields, London SE1 8DJ ▫ [redacted]

Secretary of State must consider "the formulation of the individual offences proposed, in particular to consider whether they focus on the behaviours being targeted without criminalising behaviour more widely". Nor would changing the existing s397 offences be proportionate to the issue being addressed.

Alternative solutions

There are potentially more appropriate and effective alternatives to achieve the policy objectives. For example:

Create a new criminal offence for LIBOR manipulation, based on parts of s397 or on EU proposals for a benchmark related market abuse offence*:* Rather than amending s397, LIBOR manipulation could be criminalised through the creation of a new offence (for example, as a new s397A) which does not disturb the scope, application or effect of the existing offence. The new offence could be formulated in a way which does not require the false or misleading submission or information to have been made for the purpose of inducing behaviour by others in relation to relevant investments, but instead only to have been made knowingly or recklessly with the intention of manipulating or distorting the calculation of the benchmark. Such an offence could, for example, be based on either:

(a) the existing s397, but with a different purpose test to the one in s397(2)/(3) - i.e. the misleading statement or conduct being for the purposes of manipulating or distorting the calculation of a benchmark (or being reckless as to the same); or

(b) the July 2012 EU Commission proposals for bringing manipulation of LIBOR and other benchmarks within the scope of both criminal and civil market manipulation. The UK is not automatically bound by the relevant EU legislative proposal (Directive on criminal sanctions for insider dealing and market manipulation (CSMAD)). However, it could consider opting-in or, for an earlier and more flexible solution, introducing an equivalent new criminal offence without waiting for the EU proposals to be implemented. This would also avoid the creation of significant disparities between the regimes operating in different EU member states – 'level playing field' issues. (In suggesting this approach, we make no comment on the merits of the EU Commission's proposal or drafting.)

Rely on existing Fraud Act 2006 and other fraud law: The SFO has announced it is satisfied that existing fraud offences are capable of covering conduct relating to the alleged manipulation of LIBOR. To the extent, however, that there are nonetheless concerns as to whether the manipulation of LIBOR would be covered by the Fraud Act offences, then, if these stem from doubt as to whether an inaccurate LIBOR submission would constitute a "false representation", we note that the same issue could arise under the re-cast s397 offence (in demonstrating the misleading nature of the statement).

Reliance on the current criminal law (whether or not taking into account a reformed LIBOR setting process) could be coupled with an extension of the powers/practices of the FSA (and, in the future, the FCA) in relation to the prosecution of fraud (for example through the Financial Services Bill), in certain types of circumscribed situations. Whilst we do not consider that the FSA/ FCA should become a general fraud prosecutor, it might be possible to link additional prosecutorial powers/practices to criminal conduct which impacts the FSA/FCA's statutory objectives in relation to market confidence or financial stability, for example.

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Any of these solutions seems preferable to amending s397 as suggested in DP.

We would be delighted to discuss these issues further with you.

Please note, as a matter of formality, that the views expressed in this letter do not necessarily reflect those of each and every individual member of the GC100 or their employing companies.

Yours faithfully

Mary Mullally
Secretary, GC100
[redacted]

Secretary: Mary Mullally ▫ 19 Hatfields, London SE1 8DJ ▫ [redacted] ▪ [redacted] ▪ [redacted]

7 September 2012

Commissioner Michel Barnier
European Commission
Brussels
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Spain

Re: Principles for Financial Benchmarks

Dear Sirs and Madam:

Recent events have called the integrity of some of the most significant global financial benchmarks, such as LIBOR, into question and have prompted numerous policy-makers to study enhancements to the benchmark-setting process. The Global Financial Markets Association[1] ("GFMA") believes that the events related to LIBOR point to a need for a broader consideration of financial benchmarks used in the marketplace, and to determine what common practices need to be in place to enhance market integrity generally. We strongly believe that international standards are needed to govern issuance of financial benchmarks.

In view of this, GFMA has given high priority to developing the enclosed statement of Principles for Financial Benchmarks ("Principles"). In doing so, GFMA member firms worked to devise a

[1] The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, visit http://www.gfma.org.

broadly accepted set of best practice standards for conducting benchmark price assessments that would serve to enhance confidence in such assessments and, more generally, would promote both the integrity and efficiency of the global financial markets.

We welcome the review of the regulatory framework for financial benchmarks by the global regulatory community. GFMA recommends that this review should be coordinated globally to ensure consistency and encourages the regulatory community to consider the enclosed Principles as a basis to guide the development of a regulatory regime. GFMA suggests that a regulatory regime should adopt the following concepts:

- All systemically significant financial benchmarks should be subject to regulatory oversight.

- To ensure that regulation is appropriately scaled and targeted, where a benchmark sponsor or other participant is already regulated by a prudential regulator, then that regulator should oversee the implementation of the agreed-upon standards within the entity, in a manner that reflects the significance of the benchmark being regulated.

- Where no financial regulator has jurisdiction over a sponsor or other benchmark participant, GFMA recommends that appropriate administrative or legislative steps should be taken to ensure application of the standards to all participants in the benchmark process, also in a manner that reflects the significance of the benchmark.

- Finally, GFMA notes that any new regulation should be developed consistently across jurisdictions, avoiding duplication, and defining clear regulatory responsibilities for oversight of individual benchmarks.

* * *

GFMA believes it is critical to the smooth functioning of global financial markets for significant benchmark indices to be subject to uniform, transparent, and sound practices. Developing these principles has been a cooperative effort among our member firms and we would welcome the opportunity to work with the regulatory community on moving forward in this important effort.

Sincerely,

Simon Lewis
CEO, GFMA

Attachments:

- Annex 1: Principles for Financial Benchmarks
- Annex 2: CC List

Principles for Financial Benchmarks[1]

07 September 2012

INTRODUCTION

Financial benchmarks are widely used as references for determining payments under a variety of financial instruments and many have a significant impact on market activity globally. The integrity of these benchmarks is critical to the effective functioning of markets and investor confidence.

Recent events have placed the integrity of some of the most significant benchmarks into question and have contributed to public distrust in the financial industry. These events have prompted policy-makers to study enhancements to the benchmark-setting process. For instance, the United Kingdom's Chancellor of the Exchequer commissioned *The Wheatley Review* to focus on the reforms to the framework for setting the London Interbank Offered Rate. The International Organization of Securities Commissions has been reviewing the need for such principles in the crude oil markets.

A broadly accepted set of best practice standards for conducting benchmark price assessment processes ("benchmark process") would serve to enhance confidence in such assessments and, more generally, promote both the integrity and efficiency of the global financial markets.

[1] In view of the understandably tight timescales set for public comment in response to current regulatory reviews of benchmarks, the Global Financial Markets Association (GFMA) is sharing these Principles as currently formulated with the appropriate governmental and regulatory bodies. However, GFMA plans to test the detailed application of the Principles over the coming weeks and may revise or clarify the formulation based on this work.

In this context, the Global Financial Markets Association[2] ("GFMA") is issuing these *Principles for Financial Benchmarks* (the "Principles"). Our objectives in doing so are the following:

- To draw attention to the need for international standards that apply to the issuance of financial benchmarks;
- To offer the Principles as a basis for crafting such international standards; and
- To urge the adoption of the Principles by organizations responsible for developing and issuing benchmarks.

The Principles recognize that benchmarks and their data inputs necessarily vary by market and reference asset type, and that many benchmarks inevitably rely on voluntary contributors and their judgment. Nonetheless, sponsors and their agents are encouraged by the Principles to solicit sufficiently deep or broad-based reference data while maintaining the integrity of the submission process and resulting benchmark price assessment.

SCOPE AND DEFINITIONS

The types of financial benchmarks vary widely, both in terms of the participants involved in developing and issuing benchmarks and in the uses and significance of the benchmarks.

For the purposes of the Principles, a benchmark will be defined as a commercial or published price assessment, distributed regularly to third parties and primarily intended for use as a reference in determining the pricing of, or the amount payable pursuant to, a financial instrument or contract. Thus, benchmarks may be established from the market prices or rates for transactions in debt or equity securities, the foreign exchange, money and commodity markets, or derivatives of any of these.

[2] The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, visit http://www.gfma.org.

For clarity, the Principles are not intended to apply to benchmarks meeting one or more of the following exclusion criteria:

1. Use

Indices that are primarily used for purposes other than pricing financial instruments or contracts are out of scope.
Examples include indices that are used primarily for the purpose of evaluating the returns or other performance characteristics of asset portfolios, and economic or market sentiment indices produced by private sector organizations.

2. Scale

Customized indices used for pricing bespoke bilateral or similar transactions among a limited number of counterparties are out of scope.
Examples include customized or privately-negotiated indices, reference portfolios or baskets, defined in connection with specific issuances of structured notes, with bespoke transactions to effect investment strategies, or with similar bilateral or limited arrangements, for which no third parties contribute data directly and for whose use no license fee is charged.

3. Public Source

Indices issued by public sector entities are out of scope.
Examples include economic indicators or other statistics published by government entities, even if some, such as inflation indices or weather data, are widely used in the pricing of financial instruments. These examples would also be excluded under the use test.

Although operating models for designing, operating and publishing benchmarks vary considerably across markets, the Principles are intended to apply to as broad a variety of models as practicable over the range of benchmarks within scope. The common elements of operating models generally comprise:

- Sponsor - an entity or group that develops and issues a benchmark.[3]

[3] Many sponsors issue multiple benchmarks. The term "benchmark" should be read in this document to mean "benchmarks", where appropriate.

- Calculation Agent - an agent of the sponsor responsible for conducting a benchmark price assessment.

- Contributor - an entity that provides data to the sponsor or the calculation agent for the purpose of conducting a benchmark price assessment.

The calculation agent may be an internal division of the sponsor or a third party contracted by the sponsor. A division of the sponsor may also act as a contributor. The Principles recognize such variation in operating models by allowing for various governance, control and conflict management mechanisms to be implemented as appropriate to the particular process or operating model.

PRINCIPLES FRAMEWORK

The overall responsibility for the benchmark process lies with the sponsor. The Principles are grounded in three fundamental sponsor obligations, which should be applied in a manner commensurate with the significance of the benchmark:

- **Governance:** A sponsor should ensure that there is an appropriate governance structure for oversight of the benchmark;

- **Benchmark Methodology and Quality:** A sponsor should employ sound design standards in devising the benchmark and ongoing processes related to its operations; and

- **Controls:** A sponsor should ensure that there is an appropriate system of controls promoting the efficient and sound operation of the benchmark process and should implement such a system of controls.

The Principles are grouped into three sections under the above headings accordingly.

THE PRINCIPLES

1. GOVERNANCE

PRINCIPLE I: OVERALL RESPONSIBILITY

A sponsor is ultimately responsible for the quality and integrity of a benchmark.

A sponsor should appoint and appropriately empower a governance body accountable for the development, issuance and operation of the benchmark. The nature of the governance body may vary depending on the benchmark and may comprise a formal board, a dedicated committee or an individual manager. In all instances, however, it is essential that there be a single identifiable authority with specific accountability for the sound operation of the benchmark.

The responsibilities of the governance body include overseeing the benchmark methodology, the control framework, and the relationships between the sponsor and any third parties. The governance body should oversee the management responsible for operation of the benchmark, take appropriate measures to remain informed about material issues and risks related to the benchmark, and commission periodic independent internal or external reviews to oversee that the benchmark continues to operate in accordance with the Principles.

PRINCIPLE II: CLEAR ROLES AND RESPONSIBILITIES

A sponsor should define clearly the roles and responsibilities of the participants in the benchmark process.

A sponsor may enter into an agreement with a third party to act as its agent in calculating the price assessment, distributing the price assessment data, or licensing the benchmark. A sponsor should establish clear roles and responsibilities for any third party charged with acting on the sponsor’s behalf. In addition, in the case where the process relies upon contributors to provide the sponsor or sponsor’s agent with market data or estimates, the sponsor should ensure that there are clear standards for contribution of data or estimates and ensure transparency regarding the nature of such participation for the end users of the benchmark. Such standards for contributors should be specified by the sponsor in a documented Contributor Code of Conduct, as described in Principle IX.

Where one or more of the functions in the benchmark process are carried out within a broader organization, the sponsor should ensure that there are policies and procedures to identify and manage conflicts of interest arising either between the various benchmark functions or between the benchmark functions and the activities of the broader organization.

PRINCIPLE III: TRANSPARENCY

A sponsor should operate with transparency with respect to benchmark development and changes, taking due account of impacts on process participants and anticipated end users.

Specifically, the sponsor should make the methodology for determining a benchmark available to those parties that the sponsor can identify as being affected by the benchmark, provide such parties with notice of any proposed amendments to the methodology for determining a benchmark price assessment and ensure that there is a process for receiving and responding to any comments on these proposed amendments.

The sponsor should also ensure that there are procedures for the communication, management and timely resolution of complaints related to the benchmark process. The sponsor should make available the complaint procedures to those parties that the sponsor can identify as being affected by the benchmark. In the case of benchmarks using contributor data, the sponsor should provide a contributor with appropriate notice if the sponsor determines that a contributor is violating the Contributor Code of Conduct. Any disputes should be handled in accordance with an appropriate dispute resolution process.

The sponsor should also make available the policies and procedures, required under Principle VI, for identifying and managing conflicts of interests to those parties that the sponsor can identify as being affected by the benchmark.

2. BENCHMARK METHODOLOGY AND QUALITY

PRINCIPLE IV: METHODOLOGY

A sponsor should ensure that there is a methodology for conducting the benchmark price assessment that relies on sound data and accurately reflects market conditions.

This methodology should:

- Define clearly the technical specifications for the benchmark;

- Be clearly documented;

- Describe the manner in which the sponsor determines the benchmark, including the responsibilities of any third parties, such as calculation agents and contributors, as well as the procedures and criteria for the application of judgment by sponsor personnel in determining the benchmark price assessment and for addressing periods where the quantity or quality of data falls below the standards set by the methodology;

- Use sound and transparent data. Where feasible, a sponsor’s methodology for determining a benchmark price assessment should give significant weight to data reflecting either executed transactions into which unrelated counterparties acting at arm’s length have entered in such sizes and upon such other terms as the sponsor may define, or executable bids and offers to enter into such transactions.

  Where such information is sparse or unavailable, a sponsor may rely on other methods for assessing prices, including dealer quotes, mathematical models that predict prices based on the observed prices of other products, good faith estimates, contributor surveys, or other methods. The sponsor's benchmark process should not be overly reliant on data from a narrow range of contributors, and should be sufficiently resilient to allow for a benchmark price assessment in the event of limited liquidity in the underlying market or market segment. Under such circumstances of limited liquidity, the sponsor should have particular regard to transparency obligations in identifying how the benchmark assessment is reached.

- Permit the sponsor or the calculation agent to exercise appropriate judgment in respect of data analysis, modeling and calculation methods to promote the integrity of the assessment.

PRINCIPLE V: BENCHMARK QUALITY

To promote the quality of a benchmark over time, a sponsor should follow best practice design elements.

Those elements include the following:

- There should be sufficient trading activity in the underlying or closely-related markets on which the benchmark is based to allow a reasonable and regular price assessment to be made.

- The trading activity in the underlying market should be conducted in such a manner and among a sufficiently broad group of participants so as to allow for transparent price discovery.

- The terms of contracts and participants to the underlying transactions upon which the benchmark is based should share sufficiently similar characteristics to minimize idiosyncratic distortion to the benchmark over successive assessments.

- While the sponsor cannot control all of the uses for which a benchmark may be employed by third parties, the design of the benchmark should reflect the broad terms of financial instruments and contracts for which it is generally intended to be used as a reference rate.

The sponsor should periodically review the benchmark design and calculation methodology, as well as the nature of activities in the underlying market, to promote continued adherence to sound design elements and reflection of market conditions.

3. CONTROLS

PRINCIPLE VI: CONTROL FRAMEWORK

A sponsor should ensure that there is an appropriate control framework for conducting and maintaining the benchmark process and for distributing the benchmark price assessment.

At a minimum, this framework should cover:

- The engagement of suitably qualified and experienced personnel to carry out the sponsor's responsibilities;

- Appropriate periodic training, including technical and ethics training;

- Policies and procedures relating to the identification and management of conflicts of interest (including through disclosure). Such policies and procedures should take into account conflicts arising from the other activities of the sponsor, the calculation agent, or contributors;

- Policies and procedures for safeguarding confidential information, including confidential information received from contributors, and controls to prevent the premature, unauthorized or preferential disclosure of information concerning a benchmark price assessment;

- Policies and procedures for receiving, investigating, reporting, and documenting complaints or potential errors with the sponsor's benchmark price assessment, including a process for escalating complaints, as appropriate, to the sponsor's governance body;

- Policies and procedures to ensure that emerging issues that may affect market integrity are brought promptly to the attention of the appropriate regulators;

- Policies and procedures applicable to violations of the sponsor's procedures by the sponsor's personnel or agents, or of the Contributor Code of Conduct by contributors. Such procedures should include appropriate reporting mechanisms to the sponsor's governance body;

- Policies and procedures for identifying anomalous data received from contributors, excluding such data from the benchmark process, and taking appropriate remedial actions to minimize the possibility of recurrence;

- Procedures to notify end users promptly of errors and corrections in a benchmark price assessment;

- An infrastructure, with appropriate resiliency, reflecting the significance and criticality of the benchmark to the marketplace, and a process for the periodic testing of this infrastructure; and

- A contingency plan for conducting the benchmark price assessment due to the absence of data from contributors, market disruptions, failure of critical infrastructure, or other factors.

PRINCIPLE VII: RECORD-KEEPING AND INDEPENDENT REVIEW

A sponsor, or by delegation, the sponsor's calculation agent, should maintain documentation and keep records (for a period defined by the sponsor commensurate with the significance of the benchmark) showing all inputs to the benchmark price assessment, the application of these inputs to determine the final benchmark price assessment, and the methodology utilized, as appropriate.

Such documentation should include an explanation for the sponsor's or the calculation agent's exercise of judgment, the disregard, if any, of observed transaction or contributor data, and descriptions of any pricing models defined in the methodology.

The process and methodology documentation, and the regular operational records, should be subject to a periodic review by a party independent of the benchmark process. Such reviews, commissioned by the sponsor's governance body, may be conducted by a sponsor's independent internal control function, by the sponsor's external auditor or by an independent third party, as appropriate to the scope of the benchmark and organization structure of the sponsor.

The independent review should assess the sponsor's adherence to the established methodology for determining the benchmark and the control framework relating to the benchmark in light of the Principles. The sponsor should be able to confirm that periodic independent reviews have been conducted, that any necessary remedial measures have been taken and that appropriate parties have been advised as needed of matters arising from the review.

PRINCIPLE VIII: DATA COLLECTION

A sponsor should ensure that there are appropriate controls over the process for collecting data for use in a benchmark price assessment.

Where a sponsor uses data collected directly from a contributor, these controls should include a process for selecting the contributor, collecting data from the contributor, protecting the confidentiality of the contributor's data, evaluating the contributor's data submission process, and removing or applying other sanctions for non-compliance against the contributor, where appropriate.

PRINCIPLE IX: CONTRIBUTOR CODE OF CONDUCT

Where the benchmark price assessment requires the submission of data by a third party contributor, a sponsor should ensure that there are standards for contributions, specified in a Contributor Code of Conduct, and contributors should employ appropriate controls over data submissions.

The Contributor Code of Conduct should cover, at a minimum, the following:

- The existence of a governance structure that promotes integrity among the contributor and its personnel and associated policies and procedures governing the data submission process;
- Policies and procedures relating to the identification and management of conflicts of interest (including through disclosure), including protections against insider trading, segregation of responsibilities where practicable, and informational firewalls, as appropriate;
- Policies and procedures prohibiting the coordination of, or sharing of information regarding, contributor data submissions with other contributors;
- The engagement of suitably qualified and experienced personnel, including supervisors, to carry out the contributor's responsibilities;

- The clear definition of roles and responsibilities for contributor personnel associated with the data submission process;

- Appropriate periodic training, including technical and ethics training;

- An appropriate monitoring and testing process for reviewing that data communicated to a sponsor or a calculation agent are consistent with the sponsor's methodology and the contributor's policies and procedures;

- Policies and procedures for receiving, investigating, reporting, and documenting complaints relating to the contributor's data submissions;

- Policies and procedures applicable to violations of the contributor's policies and procedures relating to the contributor's role in the benchmark process. Such procedures should include appropriate reporting mechanisms to the contributor's governance body;

- Controls for the protection of confidential information;

- An infrastructure, with appropriate resiliency, to support the timeliness and accuracy of submissions, and periodic testing of this infrastructure;

- A contingency plan for submitting data due to a failure in the infrastructure or other factors, where practicable;

- A process for retaining records relating to data provided to a sponsor, including documentation deemed the most relevant by a contributor in its assessment, in a form which facilitates subsequent review; and

- A periodic independent internal or external review of the contributor's data submissions and control framework.

* * *

The following Institutions have also been copied:

Australia

Auditing and Assurance Standards Board (AUASB)
Australian Accounting Standards Board (AASB)
Australian Prudential Regulation Authority (APRA)
Australian Securities and Investments Commission (ASIC)
Australian Transaction Reports and Analysis Centre (AUSTRAC)
Financial Reporting Council (FRC)
Financial Reporting Panel (FRP)
Reserve Bank of Australia (RBA)

Austria

Financial Market Authority (FMA)

Belgium

Financial Services and Markets Authority (FSMA)

China

Ministry of Commerce
National Association of Financial Market Institutional Investors (NAFMII)
The China Banking Regulatory Commission (CBRC)
The China Insurance Regulatory Commission (CIRC)
The China Securities Regulatory Commission (CSRC)
The National Development and Reform Commission (NDRC)
The People's Bank of China (PBOC)
The State Administration of Foreign Exchange (SAFE)

Cyprus

Cyprus Securities and Exchange Commission (SEC)

Denmark

Finanstilsynet

European Bodies

European Banking Authority (EBA)
European Central Bank (ECB)
European Securities and Markets Authority (ESMA)
Members of the European Commission
Members of European Parliament

Finland

Finnish Financial Supervision Authority (FIN-FSA)

France

Autorité des Marchés Financiers (AMF)

Germany

Federal Financial Supervisory Authority (BaFin)

Global Bodies

Basel Committee on Banking Supervision
G20 Finance Ministries
International Association of Insurance Supervisors

Greece

Capital Markets Commission (CMC)

Hong Kong

Hong Kong Monetary Authority (HKMA)
Securities and Futures Commission
Financial Services and Treasury Bureau

Hungary

Hungarian Financial Supervisory Authority (HFSA)

India

Securities and Exchange Board of India (SEBI)
Reserve Bank of India

Indonesia

Bank Indonesia
Bapepam

Ireland

Central Bank of Ireland

Italy

Commissione Nazionale per le Società e la Borsa (CONSOB)

Japan

Bank of Japan
Financial Service Agency
Securities and Exchange Surveillance Commission

Latvia

Financial and Capital Markets Commission (FCMC)

Lithuania

Bank of Lithuania

Luxembourg

Commission de Surveillance du Secteur Financier (CSSF)

Malaysia

Bank Negara Malaysia
Labuan Financial Services Authority (Labuan FSA)
Securities Commission

Netherlands

Netherlands Authority for the Financial Markets (AFM)

Philippines

Central Bank
Department of Finance
Securities and Exchange Commission

Poland

Komisja Nadzoru Finansowego (KNF)

Portugal

Comissão do Mercado de Valores Mobiliários (CMVM)

Singapore

Monetary Authority Singapore
Ministry of Finance

Slovakia

National Bank of Slovakia

Slovenia

Securities Market Agency (SMA)

South Korea

Bank of Korea
Financial Supervisory Service (FSS)
The Financial Services Commission (FSC)

Spain

Comisión Nacional del Mercado de Valores (CNMV)

Sweden

Finansinspektionen

Taiwan

Central Bank of the Republic of China
Financial Supervisory Commission
Ministry of Finance, ROC

Thailand

Bank of Thailand (BOT)
Ministry of Finance
Securities and Exchange Commission

United Kingdom

U.K. Financial Services Authority (FSA)

United States

U.S. Commodity Futures Trading Commission (CFTC)
Board of Governors of the Federal Reserve System
Federal Reserve Bank of New York
Federal Deposit Insurance Corporation (FDIC)
Municipal Securities Rulemaking Board (MSRB)
Office of the Comptroller of the Currency (OCC)
U.S. Securities and Exchange Commission (SEC)

Vietnam

State Bank of Vietnam

Dear Martin

I attended the launch event on your review last Friday. We are looking closely at developments on LIBOR and will respond to your consultation.

I wanted to brief you on a new ICAEW project to develop guidance for external auditors on providing assurance on benchmark interest rate submissions. We have not yet made any public statements on this project, but will do so shortly once we have informed key stakeholders, including yourself and HM Treasury.

We have taken on this project in light of the CTFC requirement that Barclays have their submissions reviewed by external audit for the next 4 years, in the expectation that other banks may be subject to similar requirements and further banks not subject to regulatory requirements may choose to do so voluntarily.

We are aware that the LIBOR process may change, and that, although external audit is an option under consideration in your review, it may or may not be mandated. However, given that a number of banks may be required to obtain such assurance by regulatory orders, we believe there is a need to develop auditing guidance, based on international auditing and assurance standards. Although the CFTC order provided some specific points to be addressed, questions remain as to the form of reporting and extent of forensic analysis expected for which an agreed approach would be useful. We also think that such guidance may be of benefit to other international regulators, as in the absence of it, they may request their own (potentially different forms of assurance).

Developing professional guidance of this nature takes some time, so we want to start immediately. We aim to publish a consultation draft before the year end, but this is a very ambitious timetable – our recent project to update our guidance on s166 reports took approximately 12 months to complete. If this project was undertaken by an auditing standard setter, it would be likely to take significantly longer.

To address the risk that our guidance may become quickly out of date and to make it most useful, we will pitch it at a level capable of being used for different benchmark interest rates. If your and other reviews conclude that external audit need not be mandated, our guidance will still be available for those who choose to engage an external auditor review.

We are keen to work with the FSA and other regulatory bodies to ensure that you think our guidance provides a robust basis for such assurance. We had an initial meeting between a small group of our members and Lee Piller last Thursday at which we agreed in principle that we should proceed and to consider how to obtain FSA input. We will also seek input from other regulatory bodies. Robert Hodgkinson met with some of your counterparts at the CFTC on Friday, who supported us in taking on this project, and we will continue to engage with them. We will also look to engage with HM Treasury, IOSCO, the European Commission and, of course, FRC. We agreed that we would provide the FSA and other interested regulators with an opportunity to input prior to publication of our consultation.

We will continue to liaise with Lee and his colleagues on the development of our guidance, but would be happy to brief you and/or your review team more fully on our work on this. Please also let me know if you would like us to inform your media team in advance of any public statement from us.

Kind regards

Iain

Iain Coke
Head of Financial Services Faculty

[redacted]

Our ref: ICAEW Rep 131/12

The Wheatley Review
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Via email: wheatleyreview@hmtreasury.gsi.gov.uk

7 September 2012

Dear Sir or Madam

Wheatley Review of LIBOR: initial discussion paper

ICAEW is pleased to respond to your request for comments on the Wheatley Review of LIBOR: initial discussion paper.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

Philippa Kel

Philippa Kelly
Technical Manager, Auditing and Reporting

[redacted]

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ICAEW REP 131/12

ICAEW REPRESENTATION

WHEATLEY REVIEW OF LIBOR

Memorandum of comment submitted in September 2012 by ICAEW, in response to the Wheatley Review of LIBOR: initial discussion paper, published by HM Treasury in August 2012

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the Wheatley Review of LIBOR: initial discussion paper, published by HM Treasury on 7 August 2012 and which is available from the following link http://hm-treasury.gov.uk/d/condoc_wheatley_review.pdf

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 138,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

4. The Financial Services Faculty was established in 2007 to become a world class centre for thought leadership on issues facing the financial services industry acting free from vested interest. It draws together professionals from across the financial services sector and from the 25,000 ICAEW members specialising in the sector and provides a range of services and provides a monthly newsletter FS Focus.

MAJOR POINTS

5. We believe that it is possible to strengthen LIBOR in its current form so it can remain fit for purpose as a benchmark rate. This will avoid lengthy and widespread ramifications for existing contracts and maintain continuity during a time of existing economic instability.

6. We believe that external assurance can be an important feature in increasing confidence in the reliability of interest rate benchmarks. We note that Barclays have been required to obtain external assurance on their interest rate benchmark submissions by the Commodity Futures Trading Commission (CFTC). Given the increasing number of banks facing direct regulatory scrutiny both domestically and internationally we are of the view that the demand for assurance could be far reaching. As such we are currently developing guidance in this area. Guidance will help ensure uniformity and a standard level of work and therefore confidence in audit reports or opinions.

7. The LIBOR scandal does not have a single cause but many of the instances of behaviour which led to manipulation of submissions should be addressed at an organisational level. Increased regulation will not necessarily change behaviours, and organisations must look closely at their culture and tone at the top. This is vital to ensure ethical and fair behaviour is appropriately incentivised and encouraged. This idea is further addressed in our separate response to The Parliamentary Commission on Banking Standards.

RESPONSES TO SPECIFIC QUESTIONS

Do you agree with our analysis of the issues and failings or LIBOR?

8. We are in agreement with the review team that the reach and influence of LIBOR is difficult to quantify with precision. LIBOR has established itself as a key rate, and is by far the most commonly used, but is one of many international benchmarks. The importance of the London benchmark specifically should not be underestimated, both in terms of the value of loans and contracts that reference it and in reinforcing London's position as a leading financial centre.

9. Without detailed impact studies any changes made to the construction or form of LIBOR would be difficult to predict. Interest rate benchmarks are used because they meet a market need. The scale of their use, and longevity of some of the outstanding contracts, means that changes to LIBOR should be handled carefully. The most practical way to reform LIBOR would be in such a way that new-LIBOR retains the same underlying objective of providing a daily point-in-time estimate of the rates that banks expect to borrow at.

10. Replacing LIBOR with an alternative measure could cause significant market disruption as the legal position of each underlying contract may need to be clarified. It may be possible to develop an alternative benchmark that could be used in future contracts, while retaining LIBOR until existing positions unwind, although we believe that the choice of benchmark should be a market decision.

11. Various changes have been suggested that affect the objective of the benchmark, for example to have a rate based upon what a bank would expect to lend to another bank at a specified credit rating. While these alternatives may or may not provide a better indicator, and markets may choose to use these in the future, as this would represent a change in the objective of LIBOR, it may undermine existing contracts. It may, in contrast, be possible to change the methodology of calculating LIBOR, for example by giving added weight to real transactions (or even basing LIBOR on real transactions), without causing major market disruption, as the underlying objective may remain the same.

12. There is a parallel in accounting to changes in measurement bases versus changes in estimation techniques. In summary, a change in an estimation technique involves finding a better way of estimating the same objective (for example how to estimate depreciation of an asset) and is not a change in accounting policy and does not require a restatement the financial statements. By contrast, where the basis of measurement is changed, for example from depreciated cost to fair value, this is a change in accounting policy so requires the prior year financial statements to be restated.

13. In response to the assertion that the need for expert judgement on the part of the submitter is a weakness of LIBOR[1] the ICAEW believes that this is not a problem per se. Whilst the need for judgement inherently means there is a greater possibility of manipulation, removing judgement does not guarantee credibility or ethical behaviour of individuals, which is ultimately what is required. Removing judgement from the process can risk removing some sense-checking against real market events and conditions.

14. We agree with the review team that banks should be required to maintain proper records to support their interest rate benchmark submissions. Such records are necessary to allow proper reviews over processes, and will be essential if submissions are to be subject to assurance from internal or external auditors. Given that interest rate benchmarks are submitted daily, covering several currencies and durations, the documentation requirements would need to be relatively straightforward to allow the process to be completed efficiently.

15. We agree that the governance processes around the review and compilation of LIBOR, currently undertaken by Thomson Reuters and the BBA, should be reviewed. It is important that submissions are compared with expectations, and there is a mechanism for taking action if submissions appear suspicious. The review team has highlighted concerns in this area and we agree that these should be examined.

16. It has yet to be established who suffered losses due to LIBOR manipulation. It is likely that there will be winners and losers, particularly from alleged manipulation by bank traders. It is also not clear that the banks themselves benefit from any manipulation by their staff as, although manipulation may have favoured individual trading positions, they may not have favoured the net position of the banks. Some analysts estimated that US mortgage borrowers

[1] The Wheatley Review of LIBOR: initial discussion paper p 15

may have benefited from LIBOR manipulation. However, given the importance of LIBOR submissions, the damage done to confidence in the financial system by LIBOR manipulation may well exceed the gains and losses arising from it.

Can LIBOR be strengthened in such a way that it can remain a credible benchmark?

17. We believe LIBOR can be strengthened to remain a credible benchmark. Confidence in banking is at an all-time low and the LIBOR problems reinforce this. In the case of LIBOR, this is, due to the actions of people, rather than an inherent failure of the LIBOR mechanism which has operated more or less effectively since its inception. The issue rests with deliberate manipulation of interest rate benchmarks for either personal gain or to promote confidence in a bank's brand. These behaviours could be exhibited however a benchmark is derived. Hence there is the need to refocus on culture and the tone at the top.

18. We support suggestions to move towards basing LIBOR submissions more closely upon market transactions. The CFTC order on Barclays sets out a hierarchy of factors that should be considered in determining its submissions. These are sensible and would strengthen the credibility of interest rate benchmarks. While in deep liquid markets, a system based fully on real transactions might be desirable, there may be practical problems in having this too rigidly applied as there may be occasions when there are insufficient transactions by an individual bank, so real transactions may be misleading. Formalising this hierarchy should improve the process without undermining. An additional condition might be added that banks could make adjustments to this where it believes the hierarchy might lead to misleading answers, but the reasons for any such adjustments should be documented and potentially submitted to the agency collating the data. This would allow review, not only at the time but also by internal or external audit, as well as providing a paper trail to any individuals involved in influencing submissions.

19. Following their investigation into Barclay's LIBOR submissions between 2005 and 2009 the CFTC have required Barclay's to engage external auditors to perform a submissions audit on an annual basis for at least the following four years.

20. It is expected that given the political nature of this settlement and the increasing number of banks becoming implicated in the LIBOR scandal that there will be a wider call for provision of assurance over LIBOR submissions more generally. ICAEW is developing guidance for auditors on providing external assurance on LIBOR submissions, and will seek input from regulators and policymakers on its development, including HM Treasury, the FSA, CFTC and European Commission.

21. External assurance, supported by guidance based upon international standards, should provide confidence to stakeholders that there are adequate controls around the submissions process. This could include, for example, not only reviewing the processes around submissions, but carrying out reasonableness checks by comparing submissions to actual transactions. It would also assist those providing this assurance to do so on a consistent basis.

Should the setting of and/or the submission to LIBOR be regulated activities?

22. The scope of regulation would have to be carefully considered. It would have to be confirmed where regulatory responsibility would lie (likely with the FCA) and adequate resource guaranteed. In principle, setting rates such as LIBOR can be performed effectively by the private sector. Ultimately, no-one is mandated to use LIBOR, and alternatives exist, including banks own base rates which a bank can set according to its own competitive strategy. However, given its importance, there may be merit in some regulatory oversight of the rate setting mechanism to add further credibility to the rate. Banks contributing to the LIBOR panel are, of course, regulated. We note that the FSA has managed to successfully take enforcement action against Barclays, with other cases reportedly under investigation, for breach of its principles. It may be that the objective of regulatory oversight can be achieved through the FSA extending its approach to supervision without requiring additional regulation.

Should the regulator be provided with specific powers of criminal investigation and prosecution in relation to attempted manipulation and manipulation of LIBOR?

23. ICAEW supports principles based regulation. We would not favour introducing explicit offences of manipulating benchmark interest rates as we believe that the existing provisions of the Fraud Act cover these matters, in addition to the FSA's core principles. We believe that the Fraud Act is very well drafted, and would welcome case law to establish that it can cover such market manipulation. We would support extending the Market Abuse Directive so that it can cover issues such as LIBOR manipulation, but had it been drafted in a more principles based way, the Directive may have already caught this.

24. Further to this on 6 July 2012 the Serious Fraud Office (SFO) formally accepted the investigation into LIBOR. On 30 July 2012 David Green QC confirmed that criminal offences are capable of covering the LIBOR scandal. We would welcome case law confirming this, and we believe that the potential for criminal sanctions under the Fraud Act would act as a stronger deterrent than a specific regulatory sanction. There may, however, be merit in providing the FSA with greater powers to take action under the Fraud Act, for example to be allowed to direct the SFO to take on cases, or powers for the FSA and successor bodies to directly prosecute such cases.

Should there be an overarching framework for key international reference rates?

25. We believe that all reference rates should be considered to be of comparable integrity allowing users to choose the most appropriate rate for their purpose. The guidance being developed by the ICAEW for audit and assurance practitioners in this area is intended to be of sufficient scope so as to be applicable to benchmarks and indices generally, not simply LIBOR. This would benefit all Price Reporting Agencies. External audit allows a transparent and established way for them to show that they have executed their oversight responsibilities if this is considered to be most appropriate and efficient.

26. We would support the development of principles on an international level and would seek to take an active part in this. The elements which make a benchmark credible; robust methodology, credible governance structure, formal oversight and transparency are all things which would lend LIBOR to external audit which would serve to further increase confidence in credibility.

E [redacted]

The Wheatley Review
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

7 September 2012

Dear Sirs

ICAP Response to the Wheatley Review of LIBOR: Initial Discussion Paper

ICAP welcomes the opportunity to submit comments to the Wheatley Review of LIBOR. As an interdealer broker, platform operator and provider of post-trade services, ICAP is not a bank, does not participate as a principal in the deposit or derivatives markets (other than for corporate treasury purposes) and does not make LIBOR submissions; however, we believe our experience in facilitating money markets, arranging transactions in financial instruments that in many cases reference LIBOR and contributing trade data to indices such as the WMBA Sterling Overnight Index Average gives us a perspective that may be helpful in the context of the Review.

A detailed response to the consultation questions is set out at Annex A. In general, we would agree with the issues that the discussion paper identifies as having contributed to erode confidence in LIBOR and believe it should be possible for the authorities to introduce measures, in particular around governance and audit, to help restore its credibility as a benchmark. However, perhaps the most significant challenge if LIBOR is to remain a meaningful and useful private sector funding benchmark for the global economy is the lack of liquidity in the interbank unsecured money markets. As matters stand, the unsecured markets should provide the fundamental basis for the submissions of the panel banks. However, the volume of interbank lending has declined in recent years, exacerbated by the crisis but also incentivised by regulatory reform through Basel III where the capital adequacy framework in effect promotes secured (versus unsecured) lending. Unless this is tackled, LIBOR will simply serve as a benchmark of an illiquid market, with limited transaction data on which banks can base their judgement and regulators audit submissions.

You may already be aware that ICAP launched an unsecured borrowing reference rate for USD in 2008 (the New York Funding Rate, “NYFR”). NYFR was intended to be an adjunct to LIBOR rather than a replacement. More details are provided at Annex B.

ICAP appreciates having the opportunity to comment on the discussion paper and would be happy to discuss further.

Yours faithfully,

Duncan Wales

Group General Counsel

Annex A

Issues and failings with LIBOR

***Q: Do you agree with our analysis of the issues and failings of LIBOR*?**

The discussion paper identifies a number of issues that may have contributed to erode the credibility of LIBOR as a benchmark. These include the illiquidity of the unsecured interbank term deposit market; the size and composition of LIBOR panels; the governance around and regulatory oversight of the submissions to and setting of LIBOR; and the potential for daily publication of individual submissions to incentivise manipulation because of credit signalling.

ICAP agrees that these are important factors, in particular the decline in unsecured inter-bank term borrowing which was exacerbated during the crisis as a result of concerns around counterparty credit risk and which is being further reinforced by regulatory capital requirements as for example under Basel III. Illiquidity in the interbank markets inevitably means submissions to LIBOR are more reliant on judgement, and the low volume of transactions means there is limited data against which the opinions behind submissions can be corroborated. On this point, we would note that the ongoing regulatory direction of travel leads us to believe that unsecured lending is going to become a lesser, not greater, part of how banks fund themselves. If this is the case, one questions how the interbank market is going to re-emerge either as a viable market in and of itself or as anything other than a minimised, if not compromised, source of information.

ICAP shares the view set out in the discussion paper that there are shortcomings in the current governance structure around the setting of LIBOR. We agree that if the banks that provide the LIBOR submissions are also involved in the oversight subcommittee(s) then this gives rise to potential conflict of interest.

The discussion paper also takes the view that banks and individuals working for them have an incentive to manipulate submissions to signal creditworthiness or support trading positions. ICAP considers that where individual submissions to LIBOR are made public on a daily basis, and in particular when markets are thin, there may be risks around credit signalling. Information on the cost of funds is market sensitive, in particular at times of volatility or market stress, as this can be interpreted as an indicator of credit worthiness. More importantly there is also a feedback risk with potentially systemic implications. The current system effectively forces contributing banks to publicly pronounce on, and justify, their own perceived credit standing and ability to access unsecured funds from the market. In times of especially heightened risk aversion, this presents a feedback risk – i.e. a bank has difficulty accessing unsecured funds, the cost of funds increases and is disclosed publicly via the LIBOR submission, which in turn increases the difficulty in the bank's ability to access unsecured funds - that has the potential to escalate into a systemic failure of the banking system.

The alternative framework as established by the European Banking Federation for EURIBOR is somewhat different as banks are requested to submit a rate of where the best offered rate would be in each period, hence not specifically linking the submitted rates to their own credit worthiness.

Strengthening LIBOR

Q: Can LIBOR be strengthened is such a way that it can remain a credible benchmark?

We believe there are a number of measures that could be taken to help strengthen LIBOR, for example strengthening the governance arrangements that oversee calculation and fixing of the benchmark and setting clear and transparent criteria around participation as a contributing bank. As noted above, there is also an important question for the Authorities to consider in relation to the liquidity of the underlying market which has diminished in recent years as a result of the crisis and concerns within the banking sector around counterparty credit risk as well as regulatory reforms that incentivise banks towards secured (versus unsecured) lending.

Measures that you may wish to consider in the context of the Review include:

- **Amending the question that is asked of contributing banks**

There are a number of options that could be explored and we consider three possibilities:

1. **Reverting to the LIBOR definition pre-1998 (consistent with the current question asked in the EURIBOR survey), and changing the reference bank to an unspecified 'prime' bank.** This would appear to at least partly address the feedback risks (both to the individual bank and possibly the banking sector more generally through systemic channels), currently associated with LIBOR submissions that are significantly higher than the majority of the LIBOR panel and the inference in such submissions about a bank's perceived credit-worthiness and / or ability to access short-term unsecured funding from the market. In referencing a 'prime' bank rather than one's own funding costs, a bank undergoing short-term funding difficulties could perhaps be justified in viewing itself as a special case, hence its submission would not reference such difficulties unless it perceived these to be more generally experienced across the prime banking sector. However, there are a number of drawbacks with such a change as the Discussion paper notes: the level of transparency in the LIBOR measure would diminish, the degree of subjective judgement of reference rates would increase, and the auditing and governance processes used to justify submissions and police the integrity of the measure would become more difficult. LIBOR would become both less transparent and less accountable and ultimately, this might undermine rather than underpin its credibility as a measure of banking sector funding costs.

2. **Extending the definition to also include unsecured funding sources from non-banks** (e.g. corporate deposits, pension funds, money market funds). Such a change occurred with the WMBA's SONIA fix in June 2003 and reportedly resulted in a fifty percent increase in turnover captured by the fix. This would move LIBOR more into line with banks' actual funding models, where non-bank sources have become an increasingly important source of funds. There would also be more transaction data available which would help to reduce the reliance on inference and judgement. However, some account would need to be given to the potential diversity of bank funding models as well as the risk preferences of the lenders and differences in liquidity premia.

3. **Change the question to reference the rate a bank would offer funds to a prime bank rather than the rate it perceives it would be offered funds**. This could go some way towards addressing concerns around potential credit signalling. However, the wide dispersion of credit across the banking sector could make it difficult to arrive at a consistent, cross-market view.

- **Delaying publication of submissions**

Daily publication of individual submissions provides transparency but also introduces risks around credit signalling and, potentially, manipulation. Moving to a confidential submissions basis would minimise these risks. One option would be for all submissions to remain confidential. An alternative would be to publish only those quotes that are included in the actual estimate, and to defer publication of those that are not. Publication of those bank quotes that are not included in the actual estimate appear to serve little purpose in underpinning the credibility of the measure. Deferred publication of these rates might limit the stigma effect of submitting very high rates relative to the rest of the panel in times of extreme market stress. However those outside the calculation process would be identifiable by their omission.

- **Corroborating and auditing of submissions**

While the underlying market remains thin, it is inevitable that banks will have to base their quotes in (large) part on judgement and inference. We therefore agree with the conclusion drawn in the Discussion Paper that it is important that submissions can be scrutinised and justified *ex post* as part of an auditable process. This would include reference to transaction data and rates in correlated markets (e.g. OIS, short-term government debt markets).

- **Participation in LIBOR panels**

Broadening participation in the panels could perhaps introduce more independence and help mitigate the potential conflicts of interest that the Paper identifies.

Amending the question that is asked of contributing banks to include unsecured funding sources from non-banks could allow large corporate, fund or investment / asset management institutions to join the panel. This would give a wider market view of where the rates should be.

Extending the panels to include more banks would mean including those that are even less active in the unsecured interbank market with potentially more diverse credit ratings. This would likely increase the degree of inference and judgement inherent in the measure, and could undermine the quality of the index. It is also questionable whether additional banks would be willing to join the panel.

Q: Could a hybrid methodology for calculating LIBOR work effectively?

We understand this question to refer to a process in which a submission-based approach is augmented by the use of transaction data, where available and relevant.

ICAP agrees with the conclusion drawn in the discussion paper that basing an inter-bank lending rate purely on transactions alone would pose challenges, in particular when markets are thin (as there would be few transactions against which to corroborate submissions and there is the potential for manipulation as only a small number of transactions at off-market rates could be sufficient to move the final rate fixing).

On this basis, we believe that the current survey approach could usefully be strengthened by proper scrutiny of submissions, potentially by the regulator. Transaction data could be used to corroborate and audit the submissions. However, there will need to be some flexibility so that the methodology can be tailored to take account of market conditions and transaction size (e.g. in a stressed environment, the number of transactions may decline and as such there will inevitably be greater reliance on inference and judgement).

Q: Could the number of maturities and currencies currently covered by the LIBOR benchmark be reduced?

Yes. Overnight, one week, one month, three months and six months are key maturities for the cash markets, with other maturities tending to be extrapolations from those points. A one year rate would also be useful but the especially low level of transactions in unsecured markets at this maturity poses a particular challenge to the quality of the data.

Q: Is an alternative governance body for LIBOR required in the short term?

We do not believe it will be necessary to introduce a short term fix to the governance arrangements. Government and Parliament are working to a swift timetable and we would expect it is possible to introduce quickly the necessary reforms to the existing governance arrangements in the FX&MM Subcommittees.

Q: Should the setting of and/or the submission to LIBOR be regulated activities?

We do not consider that the setting of and / or the submission to LIBOR should become regulated activities under FSMA. The current position is that regulated activities relate to financial instruments, whereas LIBOR is not an instrument per se but a benchmark that is used as a reference point for various securities. In our view, the regulator should have sufficient authority to regulate and supervise those entities that are making the submissions, for example under the FSA’s General Principles of Business the banks are required to conduct their business with integrity, due skill, care and diligence and to put in place and operate within a proper framework of systems and controls. This framework could include a reference to LIBOR and could, if the regulator chooses, set out certain guidelines for making submissions, perhaps along the lines of those included in the CFTC’s enforcement notice against Barclays.

Q: Should the regulator be provided with specific powers of criminal investigation and prosecution in relation to attempted manipulation and manipulation of LIBOR?

We agree that the regulator should have enforcement and sanctioning powers through the civil market abuse regime. Extending the powers of the regulator to criminal investigation and prosecution would be a significant step-change from the current regime and requires further consultation. We would note however that such an approach could have consequences in terms of participation (both current and future) as banks would be concerned around the potential for criminal liabilities, in particular if the process for audit / corroboration is not clearly set out and given the already noted subjective nature of the benchmark.

Q: What role should authorities play in reforming the mechanism and governance of LIBOR?

The authorities have a key role to play in strengthening the governance of LIBOR. The regulator should have the power to ensure consistency and scrutinise and audit submissions and have oversight of the setting process through representation on the relevant committee(s).

Q: Which types of financial contract, if any, would be particularly affected by the risks of a transition from LIBOR?

A wide range of securities and derivatives are calculated with reference to LIBOR. This includes OTC derivatives contracts and commercial loans. These contracts, in particular bonds, will need to have a readily available LIBOR pricing reference for as long as they remain outstanding. It is worth noting that LIBOR-based swaps are heavily used by the corporate sector across the globe to gain access to funding markets outside their preferred liability profiles and, in doing so, increase their investor base and lower their funding costs. For example, many corporates and indeed governments with preference for floating rate funding will issue fixed-rate bonds preferred by many long-dated investors and then use LIBOR-based swap markets to transform their fixed rate liabilities into floating rate. Also, many corporates access cheaper funding sources in foreign currencies/markets and use LIBOR-based swaps to transform their liabilities back into domestic currency. Accordingly, any fundamental changes to LIBOR would have implications for the global corporate bond market.

Alternatives to LIBOR

Q: Are there credible alternative benchmarks that could replace LIBOR's role in the financial markets?

As the discussion paper notes, a number of benchmarks are in use across the market. However, none is used as widely as LIBOR (except for EURIBOR) and in most cases we do not consider these would be an appropriate replacement benchmark, although the transaction data may prove useful in corroborating submissions. For example:

- **Central Bank Policy Rate**: not ideal because of short maturity, the absence of a maturity curve, the absence of term banking sector credit premia and the potential for sudden large incremental shifts which undermines its usefulness as a hedging instrument against movements in term interest rates.
- **Overnight Unsecured Rates**: indices such as SONIA and EONIA already exist and support active interest rate swap markets. However the continued flourishing of LIBOR-based lending and

interest rate swap markets highlights the inadequacy of overnight rates as a reference rate for private sector lending contracts (including corporate bonds) and serves to underscore the need for reference rates that include significant term premia and reference banking sector funding costs.

- **Term Overnight Index Swap (OIS) Rates**: these markets generate terms rates from which a yield curve can be constructed but are not ideal as a reference point because of liquidity issues in some tenors which can lead to significant volatility. In addition, the rates are close to risk-free and do not provide any information on banking sector liquidity / credit premia.
- **Certificates of Deposit (CD)**: CD or commercial paper has been affected by counterparty credit risk concerns and volumes remain low in both the primary and secondary markets. However CD yields may be an important component of LIBOR as a measure for enabling the banks to judge the level of unsecured term rates, especially as CD investment has become a preferred investment product of the non-banking sector.
- **Treasury Bills:** this market provides a yield curve but is unable to provide a consistent maturity reference rate without having to interpolate between moving maturity reference points, which is far from ideal. These reference points could potentially be affected by possibly lumpy and changeable supply schedules and flight to quality flows. Moreover, their long-term viability rests on presumptions about future government funding models, which again is far from ideal. By way of example, the significant distortions to US Treasury Bill rates in 1984 served to highlight the problems in using government rates as a proxy for private sector funding costs and this appeared to be one of the drivers that eventually led to a shift in the pre-eminent US money market reference rate from Treasury Bills to LIBOR around that time.
- **Repo:** repo is an important component of banks' funding but liquidity in anything other than very short maturities can be thin in term repo markets and even within a single government market in a single maturity repo contracts for bonds are not homogeneous, being affected by demand for and supply of specific issues. As central banks increasingly require high grade government debt as collateral from banks there is indeed a risk that collateral available within the banking system will become increasingly scarce. Repo is, by its nature a secured form of funding, based in most cases on specific government securities, which themselves can be diverse. On this basis, repo is a very different measure with which to replace LIBOR, and should perhaps be thought of as a potential but different measure that may have market utility in the future. A repo index though could help support calculation of the LIBOR quotes and provide a means for the authorities to audit submissions, and could become a new (and although correlated ultimately dissimilar) benchmark in its own right. For example, ICAP's BrokerTec and the LSE's MTS will shortly launch a new daily repo index series for Euro sovereign bond markets. The indices will be calculated using 1-day (spot/next, tom/next) repo transactions and will be supported by actual trades rather than indicative quotes.

As a general point, the inclusion of private sector term credit and liquidity premia are very desirable features for a private sector lending benchmark and this feature has likely been a major reason for the success of LIBOR to date. Without such a benchmark, it is possible that the financial system would be more exposed to any very significant widening of public-private sector interest rates that might occur in the future in response to a re-escalation of global financial market stress (perhaps in conditions of much lower levels of government issuance which would exacerbate such a widening).

Overall, we do not believe that an alternative benchmark should be mandated instead of LIBOR. The market will migrate towards an alternative through choice, as happened in the 1980s when the US market moved from using US T-bills as the reference point to LIBOR. However, we do consider that LIBOR can be strengthened through reference to the transaction data that is available (very limited transactional volumes make this difficult in the present situation) as well as indices such as EONIA and SONIA.

Q: Should an alternative benchmark fully replace LIBOR, or should it substitute for LIBOR in particular circumstances?

We believe LIBOR can continue to be used providing governance arrangements are strengthened and there is increased transparency and audit around the contributing process.

Q: Should particular benchmarks be mandated for specific activities?

We do not believe this is necessary.

Q: Over what time period could an alternative to LIBOR be introduced?

We do not consider it is necessary to mandate the use of an alternative benchmark. If the Authorities believe it is necessary to go down this route, any transition would need to be very carefully managed. Existing securities contracts that reference LIBOR would need to be renegotiated and / or redrafted or allowed to run-off for a period of many years, if not decades. Such a move would likely require international coordination given that LIBOR is used as a reference point in many markets, and may in fact create more disruption, uncertainty and risk for issuers and investors than it would solve.

Q: What role should authorities play in developing and promoting alternatives to LIBOR?

We do not consider it is necessary to mandate the use of an alternative benchmark though one possible strategy would be for the authorities to create an alternative banking sector funding measure to run alongside LIBOR. If the Authorities elect to go down this route, any transition would need to be very carefully managed and they will need to build consensus of approach within the international regulatory community. Ultimately, the decision on the choice of benchmark instrument should be determined by real economy risk requirements, the financial markets and the participants to the contract.

<u>Potential implications on other benchmarks</u>

Q: Are there other important markets or benchmarks that could face similar issues to those identified relating to LIBOR?

We note that in this context the Discussion Paper highlights the role of Price Reporting Agencies (PRAs). We are aware of the work underway in this regard by IOSCO and look forward to the outcome.

Q: Should there be an overarching framework for key international reference rates?

We do not believe this is necessary. Different markets are likely to require different types of benchmark. However there may be some benefit in agreeing (perhaps through IOSCO or FSB auspices) a set of common standards for the creation and oversight of benchmark and indices.

Annex B

Overview of the New York Funding Rate

In 2008, ICAP launched the New York Funding Rate (“NYFR”). This was intended to reflect the mid market rate of the broader wholesale market for unsecured bank funding on a spot basis, and cover a wider set of instruments and source of funds than LIBOR. However it was not intended to replace LIBOR, rather to act as an adjunct that would be of more utility than the indicative rates on which the Fed based its H.15 series.

How it worked

Between 9:15 AM and 10:00 AM EST, ICAP polled market participants to obtain an estimate of the mid-market rate at which such participants believe a representative upper-tier bank borrower would be likely to borrow funds as of 9:30 AM EST in the wholesale market for unsecured bank funding at various maturities. This included not only interbank deposits but other unsecured money market funding, such as certificates of deposit or commercial paper, and borrowing from sources other than banks such as money market mutual funds.

Differences between NYFR and LIBOR

The differences between LIBOR and NYFR were as follows:

- NYFR was intended as a larger survey, based on eligibility criteria rather than a panel, consisting of 35-50 contributing banks, all in the US.
- Contributors were asked to estimate the mid-market rate at which a representative A1/P1 bank would be likely to obtain funding, rather than the rate at which they themselves could borrow.
- NYFR rates were collected at 9:30am ET, vs. 6:00am ET (11:00am London) for LIBOR.
- Tenors included only 1-month and 3-month.
- Individual estimates were anonymous and the set of contributors to the panel were not disclosed.
- The rate was only published if at least 12 eligible participants submitted an estimate for each maturity on any day.
- NYFR was a trimmed mean of the panel quotes – the highest 25% and lowest 25%s in each tenor were discarded, and NYFR was calculated as the arithmetic average of the remaining rates for each maturity.

After declining numbers of participants making submissions, leading to several days in July 2012 where no rate could be published, ICAP decided to cease polling participants and publishing NYFR in August 2012.

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ICI Global

[redacted]

September 7, 2012

The Wheatley Review
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ
U.K.

Re: The Wheatley Review of LIBOR

Dear Sir or Madam:

The Investment Company Institute[1] ("ICI") and ICI Global[2] appreciate the opportunity to comment on the initial discussion paper on the London Inter-Bank Offered Rate ("LIBOR") by the Wheatley Review.[3] On behalf of their investors, ICI and ICI Global members collectively manage over $5 trillion in fixed income and money market instruments. These members also regularly trade in financial contracts such as futures, forwards, options and swaps. Many of these instruments contain terms that reference LIBOR. ICI and ICI Global members and their investors therefore have a compelling shared interest in ensuring that LIBOR is a robust and accurate benchmark.

We agree with the Discussion Paper's premise that the credibility of LIBOR has been eroded by alleged recent misconduct on the part of LIBOR contributors.[4] We therefore strongly support the Review team's consideration of ways to strengthen LIBOR or develop alternative benchmarks. As is evident from the Discussion Paper, however, whether this is possible and how it might be done are far more difficult questions.

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[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $13.3 trillion and serve over 90 million shareholders.

[2] ICI Global is the global association of regulated funds publicly offered to investors in leading jurisdictions worldwide. ICI Global seeks to advance the common interests and promote public understanding of global investment funds, their managers, and investors. Members of ICI Global manage total assets in excess of US $1 trillion.

[3] The Wheatley Review of LIBOR: initial discussion paper, August 2012, available at http://hm-treasury.gov.uk/d/condoc_wheatley_review.pdf ("Discussion Paper").

[4] Discussion Paper at 3.

While we appreciate the sense of urgency about formulating appropriate policy recommendations, we are concerned that the timetable the Review team has set may be unrealistic. It is critically important that the Review team have enough time to gather and digest a range of information and perspectives, enabling it to advance policy recommendations based on full and careful consideration of all material issues. In consultations with our respective members, we have not found it possible to do a thorough analysis of all of the issues raised in the Discussion Paper in the allotted time. Nonetheless, we are pleased to set forth our preliminary views below, with the hope that we will have further opportunity to comment as the examination of these issues proceeds.

At the outset, we should note that strengthening the credibility of LIBOR, and restoring investor confidence in it, seems preferable to replacing LIBOR with a new benchmark. As the Discussion Paper acknowledges, LIBOR has become fundamental to the financial system, serving as a reference value for transactions with a notional outstanding value of at least $300 trillion. It is far from clear, certainly at this stage of the review process, whether any alternative to LIBOR would be feasible. In any event, an alternative benchmark would have its own limitations, and migration to an alternative would entail its own risks as well as considerable practical hurdles and costs. While challenging in its own right, strengthening and reviving the credibility of LIBOR would avoid a number of operational challenges associated with replacing the benchmark. To that end, we recommend making the rate-setting process more fact-based and transparent. This might be done, for example, by using transaction-based data in LIBOR calculations wherever possible. We also support methods to improve governance of the rate-setting process. Our views are discussed in more detail below.

Background: The Importance of LIBOR to Investment Companies

As managers of money market mutual funds and short-term bond funds, ICI and ICI Global members invest billions of dollars on behalf of shareholders and clients in short-term instruments indexed to LIBOR. These instruments include commercial paper, certificates of deposit, syndicated bank loans, corporate bonds, and mortgage-backed securities. Many members also trade derivative contracts on behalf of shareholders and clients that have terms that reference LIBOR, such as futures, forwards, options and swaps. Despite recent deficiencies, LIBOR remains the primary measure of interbank funding costs and hence is a good measure of bank credit risk. Having an accurate assessment of bank credit risk is critical to the pricing of many financial instruments. Because of its important role and because it is so deeply embedded in the financial system, we generally support efforts to maintain and improve LIBOR.

Recommendations for Preserving and Strengthening LIBOR

Although we concur with the Discussion Paper's conclusion that the credibility of LIBOR has suffered recently, it is important to recognize that, even in its compromised state, LIBOR retains a number of strengths. For example, LIBOR generally has fluctuated with market determined rates, so it still reflects the term structure of short-term interest rates and interest rate expectations. Also, LIBOR, however imperfect, continues to be the best available measure of interbank funding costs: banks are often key counterparties involved in short-term dollar instruments tied to LIBOR and must necessarily fund these positions at interest rates that vary with LIBOR.

These benefits of LIBOR, as well as the challenges of developing and migrating to a new benchmark (discussed in more detail below), underlie our preference for preserving, strengthening, and thereby restoring investor confidence in LIBOR. To that end, we support exploring the use of transaction data and other verifiable empirical data to corroborate submissions. We also support steps to improve the governance and oversight of the LIBOR process. We recognize, however, that if the administrative costs and burdens placed upon LIBOR contributors becomes too high, these banks may cease to participate. Thus, any consideration of reforms to LIBOR must take proper account of the impact on participants.

Recommendations on the Rate-Setting Process

As the Discussion Paper explains, the availability of data on transactions underlying LIBOR varies widely across maturities and currencies.[5] We support using available transaction data on bank borrowings to corroborate LIBOR submissions in those maturities and currencies where there is sufficient data to do so -- *e.g.,* for shorter term rates based on the US dollar, Euro, and Sterling. We further recommend that the calculation methodology clearly set forth a minimum level of transaction data for each currency and maturity that must be available for this "direct" corroboration.

We recognize that there are limitations to the use of transaction data. Nonetheless, we believe the benefits of this approach outweigh the costs. For example, the use of direct transaction data will only be possible for a subset of existing LIBOR rates, meaning that the calculation methodology will vary across rates. It appears, however, that the rates for which sufficient transaction data are available are among most heavily used, so the approach will have a widespread, if not comprehensive, benefit.[6] The use of actual transactions also may increase the measured volatility in rates, to the extent that it replaces bank estimation techniques, but we believe this potential cost to end users of LIBOR is an appropriate tradeoff for a more robust benchmark. Finally, participating banks may have legitimate concerns over providing proprietary transaction data. Those concerns could be mitigated by making the data available only to regulators or to some trusted agent subject to appropriate safeguards.

As to maturities and currencies for which specific transaction data are less available, we believe further study is necessary to determine whether these LIBOR rates should be maintained. If they are to be maintained, other data sources should be explored to aid in their calculation. For example, data for other durations could be used for corroboration by interpolating the yield curve. To the extent such data are used, the calculation methodology should clearly explain how the rates are calculated.

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[5] Discussion Paper at 24.

[6] At a minimum, the majority of ICI and ICI Global member transactions that reference LIBOR are based on the rates where significant transaction data is available.

Alternatively, narrowing the coverage of LIBOR with respect to those currencies and maturities for which transaction data are extremely limited may be appropriate, and would have the added benefit of reducing the administrative burden on reporting banks.

Recommendations on Governance and Oversight

We support exploration of several ideas in the Discussion Paper with respect to improving the governance and oversight of the LIBOR-setting process. As noted above, we are cognizant that overburdening contributing banks may ultimately reduce their incentive to participate, but we believe several suggestions in the Discussion Paper are beneficial without being overly burdensome, and may in fact redound to the benefit of contributing banks.

For example, the proposed code of conduct described in the Discussion Paper[7] could improve the submission process and results, while also enhancing the reputation of participating banks. As the Discussion Paper recognizes, however, the effectiveness of such a code will in large part depend on the credibility of the oversight provided by the designated governing body. In this regard, expanding membership of the Foreign Exchange and Money Markets Committee, which oversees LIBOR, to include a wider range of interested groups could enhance the scrutiny and oversight of LIBOR. As the Discussion Paper suggests, increasing the presence of representatives such as non-contributing banks, exchanges and clearinghouses, and users of financial products may be beneficial.[8]

We agree with the Discussion Paper that the effectiveness of such a code would also depend upon the ability to sanction contributors for misconduct, which is something the Paper recognizes is difficult for an association without regulatory or self-regulatory responsibilities to undertake. Three options, which could operate in combination or separately, are suggested to address the enforceability of the regime: full regulation under the Financial Services and Markets Act of 2000; standalone application of the civil Market Abuse regime; and criminalization of breaches of the code. We recognize that each approach has benefits and drawbacks. The analysis undertaken so far, however, is insufficient to demonstrate clearly what the most effective solution would be. While we support the objective of a code that has "teeth," the implications of these types of reforms highlight the need for the Wheatley Review to engage in a thoughtful and deliberative process before making its policy recommendations.

[7] As set forth in the Discussion Paper, such a code of conduct could cover, for example: internal policies covering the submission process, including compliance, audit, and record-keeping; organizational structures, in terms of where the LIBOR submitting function should be located within the bank; and disciplinary procedures. Discussion Paper at 27.

[8] Discussion Paper at 26.

Challenges of Developing and Migrating to a New Benchmark

ICI and ICI Global members are skeptical about the potential for developing a workable alternative benchmark in place of LIBOR, and have deep concerns about the practical implications of a migration to a new benchmark.[9] As noted above, despite its recent loss of credibility, LIBOR remains a key benchmark interest rate. This is not only because it is deeply embedded in myriad existing financial contracts, but also because it continues to reflect banks' funding costs more accurately than any current alternative. The development of an alternative that adequately reflects bank funding costs will presumably implicate many of the same concerns and tradeoffs associated with improving LIBOR, and may face the additional challenge of orchestrating a large-scale migration.

Indeed, there are many reasons why investors might not migrate to a new benchmark. For example, many contracts would require renegotiation to reflect the new rate, a process that would be protracted, consume significant resources and present serious operational challenges. Moreover, counterparties are not likely to agree to a new benchmark if their interests are threatened. Further, as the Discussion Paper acknowledges, each of the approaches to migration (*i.e.,* co-existence, pegging LIBOR to the new benchmark, switching on a date certain, and discontinuation of LIBOR) present risks to market participants.[10] Another potential drawback to migration not mentioned in the Discussion Paper would be the fixed operational costs associated with moving to a new benchmark, such as the reprogramming of computer systems. And ultimately, even if viable alternative benchmarks are developed, the economic terms in any contract are a matter of choice for the parties to that contract, so there are no assurances that investors will adopt the replacement benchmark.[11]

None of these concerns should preclude further consideration of alternatives to LIBOR. It seems clear, however, that the practical hurdles and transitional costs are certain to be significant, while the benefits of an alternative benchmark by contrast are uncertain.

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[9] This is not meant to suggest that market participants will not employ alternatives to LIBOR, but rather to address the challenges associated with a regulatory approach to such a migration.

[10] Discussion Paper at 40.

[11] The Discussion Paper acknowledges this fact: "Ultimately, the choice of benchmarks for financial contracts is market-driven." Discussion Paper at 40.

For all of the reasons discussed above, ICI and ICI Global members believe that strengthening and restoring investor confidence in LIBOR would be preferable to replacing it. We commend the Review team for its preliminary consideration of ways to accomplish this important goal, and we urge it to take the time necessary to gather and digest input, so that its policy recommendations are made only after full and careful consideration of the issues.

We sincerely thank you for this opportunity to share our views. If we or our members can be of further assistance as you consider this important matter, please do not hesitate to contact the undersigned.

Sincerely,

/s/ Paul Schott Stevens

Paul Schott Stevens
President and CEO
Investment Company Institute
[redacted]

/s/ Dan Waters

Dan Waters
Managing Director
ICI Global
[redacted]

Dear Sirs,

We write to comment on the Wheatley Review of LIBOR initial discussion paper.

ICIS is an independent price reporting business specialising in chemicals, energy and fertilizers, whose published prices are widely used as benchmarks in these industries. In particular, in the UK, ICIS crude oil prices are used by HMRC as part of their tax-determination procedures, and ICIS-Heren natural gas prices are the established physical benchmark for UK spot gas trading. ICIS is part of Reed Business Information, a division of Reed Elsevier plc, one of the World's largest media organisations.

We are keenly interested in assisting the Wheatley Review process in any way we can, and would like to offer our perspective both on the benchmarking of commodities prices, and on benchmark formation in general, covered in section 5 of the discussion paper.

General observations

It has long been clear to participants in energy markets that the kind of mechanism which has operated for many years in the LIBOR market is inherently open to abuse.

"**Panel pricing**" has been discredited in energy markets for at least two decades, and occasional attempts by interested industry parties in setting up such systems have failed. An example would be the Far East Oil Prices Service (FEOPS) set up in Singapore in the 1990s, which gained no traction of any kind as a reliable source of oil pricing.

The reason for this is simple. All market participants, including brokers, are driven by conflicting imperatives: on the one hand, they *need* reliable benchmarks in order to simplify the management and measurement of their market positions; but on the other, they are *commercially driven* to attempt to drive benchmarks in a direction which favours those positions (or in the case of brokers, which favours the positions of their largest clients).

There is therefore an inherent tendency for panel systems to polarise into over-estimates on the part of sellers and under-estimates on the part of buyers, even where participants believe themselves to be submitting "honest data".

It remains a source of some surprise to us at ICIS, indeed, that panel mechanisms of the LIBOR kind continue to operate in *any* markets at all. For example, that London's **Baltic Exchange**, which generates what it terms "Baltic Forward Assessments" for both dry cargo and oil tankers on the basis of "estimates" submitted by a panel of shipbrokers, continues to enjoy credibility in international shipping markets.

Energy market participants, it appears to us, have come to the conclusion (without need for regulatory intervention) that a **key principle of benchmarking is that market measurement and the creation of potential benchmark prices cannot be entrusted to market participants.**

Experiments with prices created from **exchange-based transaction data**, meanwhile, have also failed to gain traction in physical energy markets, primarily because:

1. energy markets are not "closed systems" – that is, for every transaction taking place on an exchange, there is another taking place over-the-counter elsewhere, rendering the data emerging from the exchange inherently partial; and
2. many energy markets have extremely low transaction volumes, exposing the "exchange-created" benchmark to a methodological vacuum in the event that no transactions occur in a given market on a given day. In such cases, experience shows that the exchange typically falls back on a panel-based estimate system, which means that the prices it creates are "apples and oranges" on different days, depending on transaction volume.

Thus energy markets have turned exclusively to **independent price reporting organisations** in their quest for reliable baseline prices for inclusion in long-term contracts or as the basis for settlement of OTC derivatives. These organisations include ICIS and its major competitors Platts, Argus, OPIS (in the United States), as well as smaller niche providers of price transparency in regional markets around the world.

IPROs

Independent price reporting organisations that have achieved credibility all share a number of characteristics:

- They are **independently owned**: that is, no market participant holds a controlling, or even a substantial stake in their ownership. ICIS is part of a publicly listed, independent media organisation.
- They derive **no revenue from changes in the prices** of the commodities they cover: revenue is almost exclusively **subscription-based,** and therefore driven by our accuracy and acceptability to all sides of the market rather than whether commodities prices rise or fall. Non-subscription revenue is typically license-based – that is, prices generated by IPROs are licensed to exchanges or other market participants for use in "secondary businesses" which exploit the intellectual property inherent in the published prices.
- Our success or failure as providers of benchmarks (and therefore as businesses) is determined, in Darwinian fashion, by the market's perception of their **reliability and independence**. An IPRO whose published prices conflict with the market reality experienced by its subscribing customers is simply *not used* for benchmarking purposes. An IPRO whose market-measurement methodology produces unpredictable outcomes is likewise swiftly written out of contracts.
- They are all **journalistic organisations**. That is, they are motivated to discover and publish market information with the highest possible degree of accuracy, and that is the basis for their commercial success or failure. Their market-reporting activities are not complicit with the wishes of the marketplace, nor designed for the comfort of the marketplace; they are not passive recipients of "data submissions" but active investigators of markets; and they seek continuously to uncover information which market participants may be attempting to conceal. All successful IPROs are also news publishers, and typically regard price data as a "form of news" – data which provides an explanatory context for markets, rather than data for its own sake.
- They devote large amounts of time to the **development and evolution of their market-reporting methodologies**. It is axiomatic that *any* market-measurement methodology will be tested for weaknesses and loopholes by market participants; and that market behaviour inevitably adapts to try to take advantage of a methodology. Methodologies which remain static over long periods of time are inherently exposed to the possibilities that: *either* the market evolves in a direction which makes the methodology not fit for purpose, *or* that market participants become expert in adopting trading patterns, or information disclosure patterns, which cause a benchmark to move in their favour.
- They **publish their methodologies in full** (unlike many exchanges, oddly) and consult with the industry on all changes to methodology.
- Their methodologies are all based on **actual transactions, and verified bids, offers and spread relationships.** That is, market sentiment is not a factor in the determination of IPRO prices. Typically, they either publish "closing prices" based on market data acquired each day (the preferred methodology of Platts and ICIS in most markets) or they generate "indices" – weighted averages of that data (the preferred methodology of Argus).

- Their methodologies are typically, and perhaps counter-intuitively, **non-mechanistic**. That is, while they derive prices from actual market activity, rather than opinion, they do not constrain themselves to purely mathematical price derivation. This is because, for example, a strict **transaction-based methodology** is exposed to the possibility that transactions may occur at anomalous times, in a thin market, and for random reasons. If the stated aim is to measure market value at a set closing time, and no transactions have occurred for some minutes, or even hours, a methodology needs the flexibility to base a published price on prevailing bids and offers, rather than transactions.

IOSCO's investigation

During the extensive discussions we have participated in with IOSCO it has been widely accepted that the intention has been to address any perceived risk of manipulation in how price assessments are created rather than any to address any concerns that manipulation has taken place in the past. In fact we believe strongly that independent media organisations like ICIS have played a key role in shedding light on previously opaque markets, and are strong drivers of transparency.

As a number of more physical market players have explained to IOSCO in their submissions to the IOSCO review process, it is inherently dangerous to attempt "regulation for its own sake" in a market which, to date, has regulated itself and made enormous strides in transparency and sophistication since the 1980s.

It is simply not the case, as stated in your report, that IPROs suffer in the wider market from "a perceived lack of transparency and concerns over processes in the benchmark formation."

IPROs in energy market are probably the most transparent publishers of methodology in the world. Said transparency includes:

- Full methodological disclosure
- Publication of daily market commentary explaining the basis for price assessments

It is worth noting that IOSCO's reports to date contain *no* concrete instances of concerns over processes in IPRO benchmark formation, other than the vague observation that energy market participants may only be partially disclosing their trading activity to IPROs. Partial disclosure is an inherent fact of life in commodities markets, and IPRO methodologies are specifically designed to deal with this state of affairs.

We continue to actively support the IOSCO review process.

Regulation of IPROs

Your report says of IPROs that "These providers are usually unregulated, meaning there could potentially be a similar vulnerability to attempted manipulation as has been exposed in the case of LIBOR."

In our view, the existence or non-existence of a regulatory body is not the primary determinant of whether or not market participants attempt to manipulate a market. The primary determinant is the robustness of the methodology.

In the case of energy markets, IPRO methodologies are empirically tested on a daily basis by the markets themselves, and – as stated – those published prices which are found not to correspond to market reality are not used by the market as benchmarks.

We should point out, meanwhile, that the concept of regulation of publishing companies by financial authorities is fraught with real-world complexities. Notably:

- As outlined above, ICIS, Platts, Argus, Bloomberg, Thomson-Reuters and other publishers of energy prices are all journalistic organisations, protected and governed by freedom of speech laws such as the US First Amendment, which allows press organisations to resist government attempts to force them to disclose unpublished information, or information sources.

- Any organisation in the world with a website is free to publish market prices; and physical market participants are free to use those prices as they see fit. No regulatory authority exists for the global physical market, which counts among its participants a number of sovereign governments, such as the Kingdom of Saudi Arabia.
- Imposing disclosure requirements on IPROs raises the questions in a global context – to whom is disclosure to be made? And how would disclosure be enforced in, say, the case of a Chinese, Russian or Iranian price publisher?

The limit of regulatory involvement in energy market pricing is thus in ICIS' view realistically constrained to governing the benchmarks used by regulated exchanges.
Intervention in markets for OTC clearing of swaps based on IPRO prices, however, carries with it the risk that regulators will inadvertently:

- Decrease market transparency by reducing the flow of market information and thereby constricting our reporting, and
- Damage the market's ability adequately to hedge market risk.

OTC derivatives markets based on IPRO prices have arisen precisely because regulated futures exchanges, which trade *monthly* contracts, provide insufficiently accurate hedging mechanisms for physical markets which price on a period of a *few days*. Reducing the market's ability to trade those instruments risks pushing energy markets back to the days of spectacular oil market trading collapses, so much a feature of the 1980s before the widespread use of information from IPROs.

Hallmarks of a robust benchmark

We are in broad agreement with the principles outlined in this section of your report, but would point out:

- Formal oversight: the description given appears in reality to relate to formal oversight of market behaviour, and not of the benchmark methodology.
- Fair and open access: the benchmarks published by IPROs are, of course, their primary source of revenue, which is derived from selling information by subscription. It is not possible, therefore, for an IPRO-style system to function effectively in an environment where benchmark prices cannot be licensed on a commercial basis. We do, however, believe that subscriptions and licences to our content should be openly available to all potential customers, and not licensed exclusively.

Responses to Consultation Questions

5a: As stated above, the global international shipping market appears to be largely based on freight rates derived at the Baltic Exchange by a panel-pricing system comparable to LIBOR.

We are concerned that an overarching framework for key international reference rates should recognise the significant differences that exist between markets, and that regulators should avoid the unintended consequences of implementing actions that might profoundly disrupt energy markets. We believe that the activities of independent price reporting agencies in energy markets have made a significant positive impact on their transparency, and we would encourage the Wheatley Review to consider how positive lessons from our activity could be applied in other markets.

We are grateful for the opportunity to contribute to your review, and would be happy to discuss these issues further.

Yours sincerely

Christopher Flook

Christopher Flook
Managing Director, ICIS
CEO, CBI China Ltd
[redacted]

Staff Views on the LIBOR Manipulation Scandal and Possible Changes[1 2]

Staff in the Monetary and Capital Markets Department of the IMF, tasked to examine the LIBOR issue, do not consider the LIBOR manipulation scandal to be an immediate threat to financial stability. Reputational, operational, and legal risks, however, remain significant. The banking sector in major advanced economies is facing regulatory penalties and lawsuits related to LIBOR manipulation, alongside reputational risks and questions about the integrity of its broader operations. That said, the immediate impact on financial markets of the LIBOR manipulation scandal appears to be limited and no major disruptions are foreseen, notably since LIBOR continues to be the main floating rate benchmark and does not appear to have lost the trust of markets to the point of disrupting market functioning. Reform of the LIBOR framework is, however, an overarching imperative to anchor credibility and the integrity of the benchmark. But care should be taken to ensure that LIBOR reform does not cause serious market disruptions.

I. Background

The current LIBOR framework embeds perverse incentives and opportunities for manipulation. These weaknesses are due to a flawed setting mechanism, weak governance and lack of external accountability.

- **Flawed setting mechanism.** The LIBOR setting mechanism is intended to provide uniform standard reference rates across a range of maturities for multiple currencies on a daily basis. These rates are meant to reflect interbank unsecured lending rates.[3] However, because there are not always active interbank markets in all maturities and all currencies, the mechanism has to allow banks to submit LIBOR quotes based on their best judgment, which, in turn, creates room for manipulation. Incentives for banks in the panel to manipulate submissions have increased in recent years for two key reasons. First, since the volume of transactions in the unsecured interbank financing market has declined sharply, bank submissions of LIBOR quotes have become even more reliant on judgment. Second, since individual bank submissions are published, submitting a rate higher than that of peers during the financial crisis was being interpreted by the markets as a signal of liquidity problems, thereby increasing the incentives for banks to submit artificially low LIBOR rates.

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[1] This note has benefitted from/follows MCMDM Discussion with M. Wheatley, the Wheatley Review Technical Team and EUR-UK Desk. The views expressed in the note are those of the authors and should not be attributed to the staff, Management, and the Executive Board of the IMF.

[2] Prepared by A. Guscina, B. Momont, G. Pedras and M. Segoviano with contributions from G. Presciuttini, K. Chung and C. Kuong. Reviewed by U. Das, R. Sheehy and K. Srinivasan.

[3] LIBOR submissions are based on the polling question: "At what rate could you borrow funds, were you to do so by asking for and then accepting inter-bank offers in a reasonable market size just prior to 11 am?"

- **Weak governance.** The Foreign Exchange & Money Markets Committee (FX&MM), the body responsible for all aspects of the operation and management of BBA LIBOR, including governance and scrutiny, is insufficiently independent and lacks transparency. The FX&MM's alleged independence does not live up to corporate governance best practice, as members are predominantly drawn from LIBOR contributing banks with limited representation of other stakeholders. Furthermore, members' obligations are ambiguous as they are expected to serve as individuals representing their firms, but are also expected to act in the best interests of LIBOR and the markets it serves. Moreover, the names of individuals on the FX&MM are not published (only the firms) and minutes of meetings are not released compromising accountability and transparency even further.

- **Limited external accountability.** As LIBOR submission is not a regulated activity, there has been minimal oversight and supervision of contributing banks' systems and controls for submissions, without a standard procedure of submission corroboration at both the bank and regulatory level. In particular, compliance safeguards to ensure that submissions are not influenced by the broader business needs of contributors were either not adequate or were not enforced.

II. Recommendations

Given the importance of LIBOR as a benchmark rate and the lack of viable alternatives that would not suffer from the same or more serious flaws, the proposal to preserve its role as a main market reference rate is appropriate. However, improvements to the LIBOR setting mechanism, governance and regulatory oversight are an imperative.

- Based on the weaknesses of the LIBOR framework, some market participants have called for its substitution, while others have called for its strengthening. We believe that the LIBOR framework can be strengthened to ensure that it remains a credible benchmark.

- Despite the ongoing investigation of LIBOR manipulation, markets have not lost faith in LIBOR and market functioning has not been disrupted. This simple fact may attest to the viability of LIBOR as a benchmark. Indeed, interest rate markets have had plenty of opportunity to react to the LIBOR scandal, as the weaknesses of LIBOR have been widely discussed for some time, but LIBOR-based swaps have remained the market standard and LIBOR continues to be used as the main reference rate for a wide variety of transactions. This is even more telling as OIS-based swaps are nearly as liquid in terms of tradability, implying that a trading alternative does exist. Moreover, while it is widely perceived that LIBOR was manipulated during the crisis, with current high scrutiny it seems unlikely that it is at present misaligned.

Proposals for LIBOR reform need to be carefully considered so as to avoid causing market disruptions (via large revaluation of contracts) with potentially high costs for market participants. In addition to fines and litigation related to past manipulation of LIBOR, regulatory action, if not assessed properly, has the potential to cause further losses and litigation. A significant change in the level or in the volatility of LIBOR would result in a change of the value of existing contracts. This could result in transfers of wealth, and counterparties who stand to lose would either have to absorb losses or try to re-negotiate existing contracts, causing further operational costs. If transition arrangements, on the other hand, are imposed by authorities then that could be the basis for litigation. This might cause disruptions in the market.

Banks participating in LIBOR and related panels are facing sizeable regulatory fines. Based on Barclays' fine of approximately US$ 456 million, a market report considers three scenarios for possible regulatory fines that could be imposed on individual large-cap banks in its sample, with potential fines of nearly US$ 1 billion for each bank in the worst case scenario. [4]

Market participants embroiled in the LIBOR manipulation scandal are exposed to litigation risk, but the potential difficulty in proving claims may limit the ultimate impact of these risks. The assessment of litigation risks is difficult to quantify with any precision, but the potential impact on banks' balance sheets is significant given the widespread use of LIBOR as a reference rate. Estimates of potential damages vary widely from the order of several billion US$ to more than US$ 100bn.[5] These would come at a time when those very same banks are in the process of rebuilding their balance sheets in response to crisis-related financial setbacks and ongoing regulatory initiatives. In any case litigation risk needs to be carefully monitored as considerable uncertainty exists with regards to final outcomes.

While litigation due to past manipulations might have a low success rate, additional litigation arising from potentially ill-designed regulatory intervention can reasonably be expected to have a much higher success rate, hence rough estimates indicate that losses could be significant. Litigation resulting from regulatory intervention could see higher success rates as the parameters and actors are more clearly defined. The extent of such lawsuits will depend on the size and direction of changes to LIBOR fixings, as well as the degree of success in bilaterally renegotiating contracts. While it is difficult to quantify the net valuation impact of a possible change in the level or volatility of LIBOR, rough estimates indicate that losses could be significant. Based on industry research,[6] we estimate that *for*

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[4] Morgan Stanley "Banking – Large Cap: LIBOR Risk Sizing", July 12, 2012.

[5] Morgan Stanley, 12 July 2012: Banking – Large Cap, LIBOR Risk Sizing - Morgan Stanley estimates litigation losses of US$ 7.8bn for the OTC derivatives trading businesses of a group of 11 large-cap banks. Macquarie Research, however, estimates that total industry losses from litigation could reach as high as US$ 176bn with US$ 38bn of that coming from OTC derivatives and US$ 112bn from the syndicated loan market.

[6] Citigroup Global Markets, US Rate Strategy Notes, 23 March 2012: Potential changes to the LIBOR setting process and market impact ; Macquarie Research; Morgan Stanley, 12 July 2012: Banking – Large Cap, LIBOR Risk Sizing; Keefe, Bruyette & Woods, 16 July 2012: European Banks, LIBOR – Sizing the potential damage

every basis point change in the level of LIBOR, there would be a transfer of wealth of the order of US$ 5.2bn related to the syndicated loan market and another US$ 2.1bn related to interest rate swaps. These are very rough estimates and do not include other instruments such as mortgages, student loans, credit cards, etc. Nevertheless, these estimates give an idea of the order of magnitude of the possible impact of changes in net valuation.

There is merit in considering a gradual process to improve the LIBOR framework. To safeguard financial stability, while bolstering the credibility of the LIBOR, "near", "medium" and "long" term changes could be considered to improve individual aspects of the framework, including the LIBOR setting mechanism, governance and regulatory oversight. However, careful analyses informed by feedback from market participants will be required to arrive at sensible reforms during each stage of the process. The authorities' role should be focused on regulating and defining standards to ensure appropriate methodologies, governance and oversight practices, rather than on prescribing particular methods and processes.

Recommendations to improve the LIBOR setting mechanism could include the following.

Near Term:

- **Make contributions anonymous.** Individual contributions could either be published anonymously or with a lag (and possibly not at all, with only the fix published). This could, at the margin, make it harder for banks to modify their own subsequent submissions in light of those provided by other contributors. Moreover, an additional benefit of this change would be to remove the conflict of interest arising from potential credit-signaling. The downside of this approach, however, would be the lack of adequate transparency.

- **Using a median measure rather than a mean.** This would make the fixing less sensitive to the level of a single submission.

- **Imposing a penalty if a validation process fails.** This option, however, comes with problems of its own, not least of which the difficulty of establishing a robust validation process when the underlying market is illiquid.

- **Ensure a minimum participation in panels.** Incentives for banks or other market participants have to be aligned with the voluntary nature of participation in panels, or alternatively participation has to be made mandatory based on reasonable criteria.

Medium or Long Term:

- **Increasing the commitment value of contributions.** This would tend to make submissions more related to true market conditions. This could be achieved by making the submitted rates tradable up to certain limits, for instance in an anonymous electronic trading system. However, care would need to be taken to ensure that such a mechanism, in and of itself, does not move prices in an illiquid market.

- **Validate LIBOR rates with actual transactions.** The very nature of LIBOR, in particular its use as a reference in a wide range of currencies and tenors for which underlying markets are highly illiquid even in normal times, means that it is difficult to require that LIBOR rates be based on actual transactions. Timeliness of availability and the desire to have one common time (e.g., 11am London time) for fixings in different currencies also pose problems. It may, thus, be preferable to use actual transactions for validation purposes rather than to determine rate fixings directly. How such validation would be organized exactly will determine the extent of any additional operational burden and also who will bear the costs.

- **Broaden the scope of transactions considered for validation purposes.** Such transactions could include bank borrowing from money market funds, commercial paper, certificates of deposit, corporate deposits, and other funding sources. But even then, the depth of the underlying market will not be sufficient to cover all desired maturities and currencies, and it will be important to use such evidence carefully to avoid opening up other channels for manipulation that may be even harder to supervise and regulate.

- **We would recommend careful analysis of the impact of reducing the number of maturities and currencies for which rate fixings are published.** This has been proposed as a way around the issue of limited liquidity in underlying markets. However, this could cause high operational costs and possible litigation related to determining successor reference rates for contracts that are linked to a dropped maturity/currency pair. Dropping submissions also risks losing an implicit validity test in the current system, as submissions have to be internally consistent; i.e., the reported yield curve cannot involve sharp jumps at a particular maturity.

Recommendations to strengthen governance and oversight include the following.

Near Term:

- **Introduce a code of conduct for firms' internal compliance and oversight policies and procedures concerning submissions.** A code of conduct would make contributor banks more accountable and ensure that Chinese walls are respected.

- **Define a standard procedure of submission corroboration at both the bank and regulatory level.** This would ensure that validation of submitted rates is carried out on a consistent basis.

- **Make membership of oversight and governance functions transparent.** This could be done by publishing the names of individual members of all relevant governance and oversight bodies as well as minutes of meetings.

- **Make sure that the majority of the governing body's members come from non-contributing banks or other stakeholders.** This could be achieved by forming a new committee to govern BBA LIBOR or by broadening membership of the existing FX&MM Committee to include other affected parties.

Medium or Long Term:

- **Allocate adequate resources and expertise to support proper oversight and supervision.**

- **Bring LIBOR-related activities explicitly into the regulatory and legal framework.** We believe that designating as 'regulated activities' the setting of and/or the submission to LIBOR would be an efficient way to bring these activities within the scope of the FSA as a regulator with the necessary expertise and resources, and with the power to impose sanctions. Rather than referring to LIBOR explicitly, it would be worthwhile to explore the possibility of phrasing amendments to the Financial Services and Markets Act 2000 (FSMA) so as to capture the broader area of market benchmarks that may evolve in the future.

- **Introduce credible sanctions that will provide an effective deterrent to market manipulation.** The regulator definitely needs sufficient power to deter and punish transgressions, but the precise form of these sanctions may need to be assessed on a case-by-case basis.

INDEX INDUSTRY ASSOCIATION

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The Wheatley Review

HM Treasury

1 Horse Guards Road

London

SW1A 2HQ

September 7, 2012

Response to Initial Discussion Paper – The Wheatley Review of LIBOR

On behalf of the Index Industry Association ("**IIA**"), we are pleased to respond to the Wheatley Review. The IIA, founded in 2012, was created to represent, develop and promote the indexing industry for its members and for the benefit of institutional and individual investors. Founded by S&P Dow Jones Indices, LLC, MSCI Inc., and the FTSE Group and attracting a growing number of additional members including the NASDAQ OMX Group Inc., the IIA promotes transparency, sound operational practices, intellectual property rights, education, and effective index management practices. The members have developed extensive expertise and knowledge and a reputation for reliability and integrity in their indices over a period of decades. In the aggregate, they currently calculate over 1 million indices for their clients, covering a number of different asset classes, including equities, fixed income and commodities.

We restrict our response to Chapter 5 of the Initial Discussion Paper and in particular to the questions in Box 5.A as they are of relevance to the membership of the IIA.

Part of the IIA's mission is to consider ways to promote best practice for the index industry, which makes it a natural supporter of appropriate and proportionate industry standards. However, there are many types of indices that capture and provide information for a number of different uses from various sources of information. Therefore, we would caution against a one size fits all approach in the potential application of lessons learned from a review of LIBOR rate setting. A thorough review of the characteristics of the different types of indices that are in circulation, their methodologies, uses and user bases and the costs of creating additional layers of oversight should be undertaken before determining what, if any, of the issues relating to the setting of LIBOR rates may have relevance for other particular market measurements and whether a regulatory response is advisable with respect to a particular type of index.

Responses to the questions raised in Box 5.A of the Initial Discussion Paper

1. While there may be benchmarks in addition to LIBOR that face the types of issues that the Wheatley report has reviewed, the indices provided by our membership are fundamentally different from LIBOR, in structure, composition, construction, and maintenance. Furthermore, the structure and constitution of our membership differs fundamentally from that constituted by the BBA and its subsidiaries; for these reasons, the activities of our membership are not comparable. For example, for many indices produced by IIA

members there simply does not exist the same opportunity for manipulation, or incentives to manipulate, on the part of the index provider that the Wheatley Report asserts exist with respect to the setting of LIBOR rates. Importantly, in many cases, the inputs such as prices that are used to calculate the value of a given index are taken from a regulated exchange or otherwise constituted from actual traded prices, actual bids and offers or other observable market activities rather than based on an estimate or opinion of the price at which a transaction might take place. Additionally, in the vast majority, if not all cases, an index methodology clearly explaining the way an index is calculated, is made available to users of the index. In fact, methodologies are most often posted on the index providers' websites and accessible publicly. Finally, IIA members do not believe that the same weaknesses in governance arrangements cited by the Wheatley Report exist within their index construction and maintenance processes.

2. Whilst we support the promotion of best practice standards, we do not believe there is a need to establish a general regulatory framework to deal with oversight of other 'key international reference rates'. The failure of LIBOR was directly related to the particular flaws in the way LIBOR is created and calculated, which is fundamentally different to how other indices are created and calculated. As mentioned above, those opportunities for manipulation or incentives to manipulate the index do not exist on the part of our members, as they had for the BBA members.

3. The financial index provider industry has successfully developed into a highly competitive industry that provides high quality, substitutable indices, which are calculated accordingly to transparent index methodologies available on publicly accessible websites. Consequently, we would suggest that working together as an industry to address any perceptions of potential deficiencies would produce any desired outcome for improvement in a proportionate way with respect to the types of indices produced by our members.

<u>Summary</u>

The IIA is keen to work with relevant regulatory authorities and ensure that they are provided a thorough and accurate understanding of the index provider industry, so as to inform discussions such as the Wheatley Review. The IIA strongly believes that incremental improvements in best practice standards, to which the IIA is committed, is the appropriate method to provide clients and investors sufficient protections. Such improvement will further supplement existing structural protection such as the independence of our membership and a firm commitment to high governance standards.

Kind regards

I.I.A

Index Industry Association

The Wheatley Review
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

7 September 2012

Dear Sirs,

Response submission from the International Capital Market Association (ICMA)
Re: initial discussion paper - "The Wheatley Review of LIBOR"

Introduction:

The ICMA[1] is a pan-European self regulatory organisation and an influential voice for the global capital market. It has a membership of over 420 firms and represents a broad range of capital market interests including global investment banks and smaller regional banks, as well as asset managers, exchanges and other venues, central banks, law firms and other professional advisers. The ICMA's market conventions and standards have been the pillars of the international debt market for well over 40 years.

The ICMA notes that on 10 August the initial discussion paper *"The Wheatley Review of LIBOR"* was published for public consultation; and that the introduction in the executive summary thereof states that "The Wheatley Review, commissioned by the Chancellor of the Exchequer following the emergence of attempted manipulation of LIBOR and EURIBOR, will report on the following:

- necessary reforms to the current framework for setting and governing LIBOR;
- the adequacy and scope of sanctions to appropriately tackle LIBOR abuse; and
- whether analysis of the failings of LIBOR has implications on other global benchmarks.

This 10 August discussion paper sets out the direction of the Review's initial thinking on these issues."

The ICMA further notes that the Wheatley Review has been tasked with reporting by the end of the summer, enabling any immediate recommendations regarding the regulation of LIBOR and other benchmarks to be considered by the Government in time for any proposals taken forward to be included in the already tabled Financial Services Bill. Consequently the Review aims to present its findings to the Chancellor of the Exchequer by the end of September, only allowing for a brief period of consultation, until 7 September, on this discussion paper.

[1] For more information regarding ICMA please go to http://www.icmagroup.org/

Overall commentary on proposals:

Whilst the Review team has invited responses to 16 specific questions, as summarised in Annex C of the discussion paper, the ICMA has determined that it will be of greatest value for its submission to focus on those few points of most direct relevance to the international capital market and where it seems most likely that the ICMA may have distinctive points to contribute. In overall terms, the ICMA considers that:

(i) the authorities' focus in reforming LIBOR should be on regulating the governance of the process for setting LIBOR to ensure that it cannot be manipulated and to prevent market abuse;
(ii) it is important that any reform of the rate-setting process for existing transactions referenced to LIBOR does not disrupt the international capital market;
(iii) it is for the market to choose, as a commercial matter, which reference rates to use for new transactions; and
(iv) any market abuse should be covered by appropriate market abuse regulation.

In our response, we focus on (ii) and (iii), with the more detailed text below: (A) addressing how changes to, or transition from, LIBOR could affect certain types of financial contract; (B) commenting on certain points pertaining to the consideration of alternatives to LIBOR; and (C) offering some brief observations regarding other existing benchmarks.

Before covering these points the ICMA wishes to highlight the existence of other official initiatives concerning the overall issue, including the work of the European Commission and that within the central banking community. Inevitably there are elements of overlap amongst these initiatives and there is a risk that the proposals which emerge may not necessarily all fit neatly together. Since the implications of any combination of actual proposed changes may differ (for a variety of reasons, including that outstanding LIBOR based contracts are governed by a variety of different laws), and cannot be assessed in advance of an actual change proposal, the ICMA respectfully requests that every effort be made to sustain on-going dialogues – both between the requisite officials and with the markets. It is in everyone's best interests that the issues are adequately addressed, whilst at the same time avoiding any unnecessary adverse implications for the international capital market.

A. Comments concerning how certain types of financial contract could be affected:

1. FRNs; and other LIBOR based debt securities

Based upon Dealogic data, the discussion paper reports an estimate of ~$3tn of floating rate notes ("FRNs") with LIBOR (rather than other bases such as EURIBOR) as benchmark (as per Table 2.A). The discussion paper also indicates that the vast majority of these FRNs are based on US Dollar, Yen and Sterling LIBOR rates of either 1, 3 or 6 month tenors (as per Table 2.C), although in this analysis the discussion paper does not disaggregate the FRN data from that for interest rate swaps (of which there are an estimated $165 - $230tn).

The ICMA has sought to compile its own analysis of LIBOR based FRNs and reports its data (source: Dealogic) in Annex 1 of this response submission. This data illustrates a lower aggregate total of outstanding FRNs with LIBOR as benchmark, $1.5tn versus the $3tn reported in the discussion paper, but is in other ways broadly consistent with that reported in the discussion paper. In particular outstanding LIBOR based FRNs are predominantly US Dollar denominated, with smaller amounts of transactions in Sterling and Yen; and LIBOR rates predominantly of 3 month tenor, with smaller amounts of 1 and 6 month tenors.

Whilst performing this analysis the ICMA has also observed that there are equally significant amounts of other types of LIBOR based securities outstanding, particularly US Dollar, euro and Sterling structured finance securities (many of these are undoubtedly MBSs linked to underlying pools of LIBOR based mortgages), but also MTNs. Furthermore, the ICMA's analysis indicates that whilst 75% will have matured by the end of 2015, there is an extended maturity profile applicable to the remainder of the currently outstanding LIBOR based FRNs (as is also the case for other LIBOR based securities) – indeed some such securities have no fixed maturity date; and there are securities which although they currently pay a fixed rate of interest will start to pay a LIBOR based amount if they remain outstanding beyond some specified future date. The ICMA has also examined FRN issuance volumes over the past decade and finds that, following a period of growth, activity levels have fluctuated quite significantly through the period of the financial crisis.

In compiling its data analysis, the ICMA has focussed specifically on those transactions which include LIBOR based payments. The ICMA notes that this includes only a small amount of euro denominated activity (referencing euro LIBOR) as most such euro denominated transactions are referenced to EURIBOR; and that the aggregate amount of EURIBOR based FRNs currently outstanding is broadly equivalent to the aggregate outstanding amount of LIBOR based FRNs.

Given the ICMA's central role in sustaining and promoting an efficient international bond market, the ICMA is extremely anxious to see that LIBOR based bond contracts continue to have a readily available LIBOR pricing reference for so long as they are outstanding in the market. Naturally the ICMA is as keen as anyone that the market can have confidence in the LIBOR values which are used to price these instruments, such that current and, for so long as it remains commercially desirable to issue such instruments, future LIBOR based FRNs (and other LIBOR based securities) can be originated and traded with confidence. Clearly such confidence needs to be shared by both LIBOR based interest payers and receivers. Given this the ICMA sees a clear case for effective governance of LIBOR (or any other important reference rate or index) to restore trust in the rate setting process. This should include appropriate regulatory powers, both to discourage any abusive behaviour and to administer proportionate sanctions in case any future cases of market abuse were to occur.

The ICMA is particularly concerned by the potential for disruption in the market which could arise in case any changes to LIBOR were to lead to issues regarding the continuity of existing securities contracts. Bond contracts are bi-lateral as between issuers and each individual bondholder. This means that it is highly impractical to make changes to the use of LIBOR within outstanding contracts, as holders would have to agree any changes with the issuers – either in noteholder meetings or possibly through written noteholder votes. As LIBOR is one of the key pricing terms for a LIBOR based FRN a majority, or indeed in some cases unanimity, amongst holders would be necessary, in respect of each outstanding series of notes, in order to effect a change.

Accordingly, the ICMA is pleased to see that the discussion paper quite clearly indicates that the Wheatley Review is already highly cognisant of the need to proceed very carefully in case of any move away from the use of LIBOR – to quote paragraph 4.2: "Any migration to new benchmarks would require a carefully planned and managed transition, in order to limit disruption to the huge volume of outstanding contracts that reference LIBOR." Indeed the discussion paper also shows clear recognition that even a change which prompts a small shift in the value of LIBOR would be liable to have significant consequences – as stated in paragraph 4.25: "A non-transitory change in the LIBOR time series (a step-up or –down), or a structural increase in volatility, would have a significant effect on the value of contracts. …".

The ICMA observes that there are a range of conceptual scenarios, from one extreme of immediately "switching off" LIBOR through to the other extreme of continuing with all the existing daily LIBOR quotes calculated on the existing basis. From the ICMA's perspective the evident need to support the continuity of FRN (and other LIBOR based securities') contracts should rule out any notion of immediately switching off LIBOR. Whatever the problems that have been experienced, the negative disruptive consequences that would flow from such a change must surely be worse. Understanding that there is a reasonable desire to introduce some level of improvement to the existing daily LIBOR quotes, the questions then are what changes should be anticipated and what effect would these have.

Returning to the ICMA's concern to ensure the continuity of FRN (and other LIBOR based securities') contracts, the ICMA believes that the scope for changes to the derivation (as distinct from any enhancement of governance, regulatory powers, etc.) of LIBOR is constrained. Too great a change could potentially prompt contractual uncertainty just as disruptively as actually attempting to switch off LIBOR. Consequently the ICMA considers that it is indeed right to proceed in a carefully planned and managed way, such that any changes do not create unnecessary disruptive effects to existing FRNs (and other LIBOR based securities). The ICMA notes that any changes may impact the valuation of outstanding assets; and may also affect the market for future transactions.

As a practical matter this line of thinking should also encompass the operational servicing of FRNs (and other LIBOR based securities), where systems and procedures reflect specific details of the existing LIBOR quoting procedure. Operational risk will increase in case any changes to the existing LIBOR quoting procedure can only be supported by instigating changes to existing operational systems and procedures.

Looking at existing contracts, typical terms provide that the LIBOR rate to be used in a transaction will be found by reference to a specified Reuter's screen page (LIBO/LIBOR01), or "or such other page or service as may replace it for the purpose of displaying London interbank offered rates of major banks for [applicable currency] deposits". This then reflects the basic commercial intent of the contracting parties, which will be most suitably fulfilled so long as applicable London interbank offered rates continue to be published on the specified page (or a suitable replacement page).

In case applicable rates cease to be published, there are typically certain back-up provisions under which the relevant Agent bank will attempt to obtain direct quotes of London interbank offered rates from those banks who were previously contributing to published rates. In theory these back-up provisions should mean that it will continue to be possible to determine "LIBOR" in accordance with existing contracts even in case a relevant value is no longer being published, but significant legal uncertainties are likely, particularly given that not all parties will be residents of a single jurisdiction and not all contracts are governed by the same laws. In cases where it proves impossible to obtain suitable quotes it is also possible that these supposedly floating rate contracts could become locked into an historic LIBOR rate setting.

Additionally the ICMA is concerned by the fact that many FRNs (and other LIBOR based securities) will also have associated OTC derivatives contracts. Either issuers or bondholders, or both, may have entered into such OTC derivatives contracts to best manage their legitimate commercial interests. In many instances such OTC derivatives activity will involve swaps to transform the LIBOR based coupon flows of the bond into fixed rate flows, or some other floating basis rate flows; and these may have been sold as asset swap packages.

Where this is the case it is important to the commercial effectiveness of the combination of contracts that the determination of LIBOR is properly matched between the bond and the OTC derivative. The majority of OTC derivatives contracts are documented under market standard ISDA master agreements. It is quite likely that the effect of changes to LIBOR could lead to different outcomes under such contracts than those experienced in relation to the associated bond contracts, particularly in case a relevant value cease to be published and "LIBOR" consequently has to be determined under the relevant, different fall back provisions embedded in the respective contracts.

In the ICMA's opinion, the negative impact of these sorts of legal and commercial uncertainties would prove more damaging to the international capital markets than doubts over the on-going accuracy of the LIBOR rate setting process.

2. Certain other financial contracts

Besides the direct use of LIBOR in the pricing of FRNs (and other LIBOR based securities) there are certain other contracts in fixed income markets which could also be affected by changes to LIBOR, albeit more tangentially. One specific example which ICMA has considered is repurchase agreements (repos) documented under ICMA's GMRA[2] ("Global Master Repurchase Agreement") 2000. The LIBOR rate shows up in such contracts as a potential interest rate to be used in case of payment defaults. Whilst this term could again be frustrated in case of radical changes to LIBOR as it currently exists, the ICMA considers that this is a much more manageable concern than that in respect of FRN pricing. In fact the ICMA's latest standard contract, GMRA 2011, has already removed this specific contractual reference to LIBOR, so there will be some migration away from its use as the market increasingly shifts to documenting contracts under GMRA 2011. The ICMA anticipates that this migration will take quite some time to complete, but this would not necessarily preclude the possibility that changes could be directly integrated into new contracts which are otherwise documented under GMRA 2000 or inserted into existing contracts (by way of market participants subscribing to an agreed change protocol).

The ICMA considers that it is likely there are other such examples where LIBOR will show up within the terms of fixed income contracts, but has not had time to attempt a comprehensive examination of the market ahead of the comment deadline. So long as the far more significant concerns relating to the FRN market are suitably taken into account in determining any changes to be adopted, the ICMA does not currently perceive that this should prove to be a significant issue.

B. Points pertaining to the consideration of alternatives to LIBOR:

In the absence of a dependable daily flow of comparable data on actual unsecured interbank funding rates, across currencies and maturities, LIBOR was developed as a commercially appealing steady reference rate. This allowed banks a way to improve their ability to price their lending, whilst locking in a spread to their funding costs – thereby improving their asset and liability management capabilities. As cash and derivative markets evolved over time, the widely recognised benchmark represented by LIBOR became broadly adopted as a pricing reference for a variety of financial contracts entered into by a wide range of market participants. This background concerning "the development and use of LIBOR" is reflected in paragraphs 2.5 – 2.10 of the discussion paper.

[2] The GMRA is the most extensively used cross border repo master agreement and has reduced the risks associated with previously poorly documented repo transactions.

The discussion paper goes on to highlight (see Chart 3.A) that actual market transactions underlying LIBOR are currently concentrated in the shortest maturities, with only the few leading currencies seeing moderate activity as far out as one month maturity (three months for USD). The discussion paper recognises that this limits the extent to which actual transactions can be considered as an alternative to LIBOR, albeit that they could play some part in the process including by providing an element of corroboration of rates. The discussion paper also highlights that “even with a wider definition the number of eligible underlying transactions is likely to be small and might facilitate other users to influence the rate” (paragraph 3.13). Furthermore, if any such widening of the rate were intended to better reflect the realities of modern bank funding, the suggested array of funding instruments would have to include repo, but this would introduce unacceptable heterogeneity into the index.

The ICMA observes that, whilst the illiquidity of the unsecured interbank term deposit market is in part reflective of on-going financial crisis, the importance of that market in international transactions and its liquidity have been diminishing since at least the mid-1990s. This reflects factors such as tighter regulatory capital requirements for credit risk; competition for international equity by banks and allied pressure to improve their returns on equity; greater efficiency in FX with the automation of spot trading; the reduction in the number of European currencies with the introduction of the euro leading to the centralisation of liquidity management by international banks; the consolidation of banks and consequent reduction in credit lines to counterparties; and a switch from interbank lending to the funding of hedge funds and other securities dealers. The financial crisis has therefore served to accelerate a well-established trend and the regulatory response, in the form of enhanced capital and liquidity requirements, has reinforced this evolution. This means that, although the effects of the financial crisis have considerably exaggerated underlying problems, the unwinding of the crisis is unlikely to restore the liquidity of the interbank term deposit market. Nor can reform of the calculation mechanism of LIBOR solve the underlying problem of term illiquidity in this market. Given this, the ICMA sees that the value of reform lies in changes to best assure the production of a more impartial measure of an illiquid market.

Section 4 of the discussion paper explores “Alternatives to LIBOR” and presents an interesting comparison (Table 4.A) of interest rate instruments. As the discussion paper states (paragraph 4.17) “Each interest rate instrument has advantages and disadvantages” and “Ultimately, the decision over which type of benchmark should be used for a particular transaction will be taken depending on the intended use of the benchmark.” The ICMA notes that key attractions which aided LIBORs growth included that it offered a steady and independent market benchmark. Broadly speaking, the ICMA considers that where market participants have chosen to utilise LIBOR this is reflective of the fact that it is commercially suitable. This does not mean that alternatives would not prove suitable in some instances, but if there already were significantly better alternatives it seems reasonable to expect that the market would have migrated towards their utilisation.

In case the market is to migrate away from LIBOR to any extent it will be important for those holding both LIBOR based assets and LIBOR based liabilities to be able to migrate both their assets and their liabilities in a coordinated manner. The ICMA wishes to emphasise that, whilst it believes that it is commercially appropriate for the market to determine which benchmarks are best suited to the needs of specific transactions, this does not contradict the establishment of relevant regulatory and governance frameworks to underpin the robustness of whichever benchmark the market opts to utilise.

Given its longstanding engagement with the ECP market the ICMA has looked particularly at paragraph 4.13 of the discussion paper, which concerns "Certificates of deposit (CDs) or commercial paper (CP)". The ICMA highlights that the vast majority of ECP activity is denominated in either EUR, USD or GBP; and that the weighted average tenor of all June new issues (€, $, £) was 80 days (source: Euroclear). So activity in this market segment is concentrated in much the same way as the actual market transactions underlying LIBOR which the discussion paper illustrates (Chart 3.A).[3]

Over the years the ICMA's European Repo Council ("ERC")[4] has contributed to the establishment of a robust infrastructure to underpin the European repo market, including through the development of the GMRA; and hence the ICMA has also closely considered paragraph 4.16 of the discussion paper, which concerns "Repurchase agreements ("repo rates")". The ICMA does not disagree with what is said in this paragraph of the discussion paper, but would like to add a few further thoughts regarding difficulties associated with the possible utilisation of repo indices as potential alternative benchmarks.

Repos are a popular recommendation as an alternative to LIBOR and other unsecured money market indices. This may seem a natural choice, given that repo has become a core component of many banks funding and that term repo rates are increasingly available (the maturity distribution of repo in Europe currently being less skewed to very short terms than that of unsecured interbank deposits). Unfortunately, experience highlights the difficulties with developing repo indices beyond overnight or tomorrow/next-day ("T/N"). Features such as haircuts/initial margins and rights of substitution are sometimes cited as problems but these are not insurmountable. The real issue is the sensitivity of term repo rates to the credit and liquidity risks of collateral. This fact has obviously posed a particular problem in the current crisis, which has seen a dramatic divergence in the yields of government bonds, which form the core of the repo market and were previously treated as comparable risks.

In normal market conditions, one would look for the GC ("general collateral") repo rate in a particular currency. These are the rates for borrowing against generally-acceptable collateral, based upon the concept of a "GC basket" comprised of securities (deemed to have virtually the same credit and liquidity risks) which most or all core repo market participants are willing to accept as collateral at the same rate. Which collateral securities are accepted as GC inevitably varies over time. Thus, on occasion, securities which were formerly treated as GC will suddenly start to be refused or accepted only at higher repo rates. Alternatively, some GC securities will "go on special", which happens when the repo rate for a particular security becomes distorted as relative demand for it prompts potential buyers in the repo market to bid lower repo rates (than the equivalent GC rate) for this particular security.

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[3] The ICMA is concerned that the text of paragraph 4.13 of the discussion paper fails to convey an accurate reflection of this market segment. It is stated that "Prices of these instruments from trading in the secondary market can be used to generate a yield", but secondary market trades are not used in this way. Issuers set their pricing by basic supply and demand in the primary market, with the issuance of banks' CPs and CDs being very highly correlated to their cash issuance rates (indeed for most financial institutions their CP, CD and deposit rates are essentially the same). Paragraph 4.13 goes on to state that "CDs and CP are issued by commercial banks and hence reflect the credit risk of the issuer. CDs are also issued by some central banks (known as "bank bills"), which removes credit risk." The ICMA notes that in practice CDs and CPs are issued by a whole spectrum of banks, sovereigns, supranationals, agencies and corporates, with each issuer having its own credit risk characteristics (i.e. it is not the case that bill rates are free of credit risk). In its final point, paragraph 4.13 reports that "There are low volumes in both the primary and secondary markets for CDs and CP; these markets have been adversely affected by concerns for counterparty credit risk since 2007-08." Considering the first half of this sentence, the ICMA sees that taken in aggregate there are in fact quite meaningful levels of observable market activity (albeit concentrated in certain currencies and tenors). To illustrate, the amount of ECP outstanding continues to consistently exceed $500bn (source: Euroclear); and there is a similarly sized French market, besides other domestic markets such as those for CDs in London and Belgium. Moving on to address the second half of the previously referenced sentence, the ICMA observes that the actual pattern of market activity cannot really be so simply characterised; and in fact counterparty credit risk aversion is to some extent a positive factor for the short end of the market, where assets are less risky.

[4] http://www.icmagroup.org/About-ICMA/icma-councils-and-committees/European-Repo-Council/

So the best possible point of reference would seem to be one of the more formally defined GC baskets, which are fairly static, such as used in GC financing systems defined by CCPs or (in the case of Sterling DBV) the settlement system. The stability of most of these GC baskets depends on the guarantee offered by the CCP and/or their eligibility for refinancing at the central bank.

However, to date, formal baskets have generated only overnight indices, for example GC Pooling EUR Overnight Index ("GCPI"). The limitation of formal GC basket indices to the overnight tenor suggests that liquidity is skewed towards overnight and/or that collateral risks are still an issue within such baskets and make term repo rates too divergent, notwithstanding CCP or central bank guarantees (perhaps because of higher haircuts/initial margins and greater exposure to margin calls on some securities in a basket). But, even overnight and other one-day indices do not appear to have been widely adopted by the market; and in the case of the GCPI, there is a problem in that this index is relevant only to those banks which are members of Eurex Repo.

Nevertheless, the ICMA also highlights that the market is continuing to evolve and notes that in the US the DTCC GCF Repo Index fixing (overnight) is now being used as a benchmark for repo futures, which NYSE Liffe have recently started clearing. Meanwhile in Europe a topical example is the 20 August announcement that in Q4 2012 BrokerTec and MTS will launch a daily repo index series for the sovereign bond markets of the main eurozone countries. The indices will be calculated with one-day repo transactions, which represent the bulk of trading activity; and will be backed by traded volume, executed on electronic trading platforms and cleared via central counterparties, rather than based on indicative quotes.

C. Brief observations regarding other existing benchmarks:

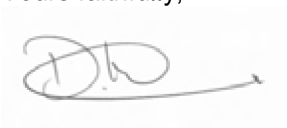
The ICMA notes that the discussion paper already explores "other inter-bank rates" (paragraphs 5.5 – 5.9) including, but by no means restricted to, EURIBOR (which, although similar in some respects to LIBOR, is already subject to its own, different derivation procedures); and that it notes the SONIA and RONIA indices created by the WMBA. Given the extensive engagement which ICMA has with the European repo market, another index which is of particular interest to ICMA is Eurepo, which is sponsored by the European Banking Federation (EBF) and published by Thomson Reuters.

Eurepo is the rate at which, at 11.00 a.m. Brussels time, one bank offers, in the euro-zone and worldwide, funds in euro to another bank if in exchange the former receives from the latter the best collateral within the most actively traded European repo market. The range of Eurepo quoted maturities are T/N, 1, 2 and 3 weeks and 1, 2, 3, 6, 9 and 12 months, and these quotes are derived from panel banks submitting the best bids in the market – however, panel banks submitting the bids are expected, under normal circumstances, to transact at these levels. Eurepo may be used in a number of ways in financial markets (e.g. basis swaps against EURIBOR).

Concluding statement:

The ICMA appreciates the valuable contribution made by the Wheatley Review through this public consultation process and would like to thank the Wheatley Review for its careful consideration of the points made in this response, which the ICMA would be happy to discuss in a meeting with the Wheatley Review team should they consider such to be helpful. The ICMA will continue to closely follow related developments and remains at your disposal to discuss any of the above points, or any further questions which may be relevant to the assessment of international capital market impacts as work progresses.

Yours faithfully,



David Hiscock
Senior Director - Market Practice and Regulatory Policy
ICMA

Annex 1

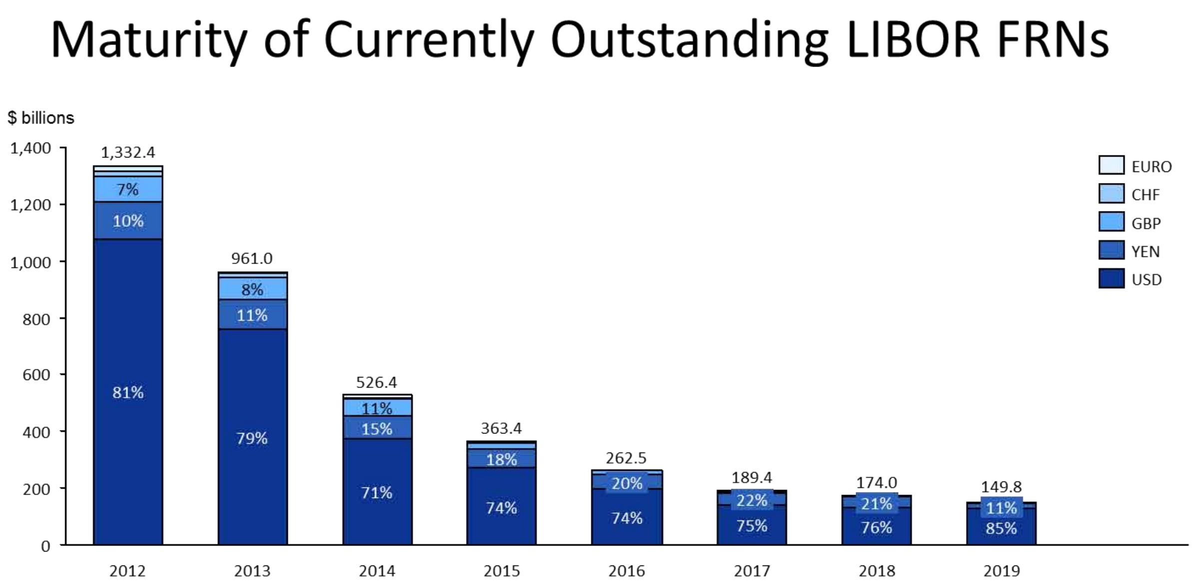
ICMA analysis of LIBOR based FRNs

For the purposes of its analysis of LIBOR based FRNs, the ICMA has sourced Dealogic data to identify transactions with FRN issue types. On this basis, the ICMA finds that there is an amount of $1.5tn equivalent of outstanding FRN transactions with LIBOR as benchmark as at 24 August 2012.

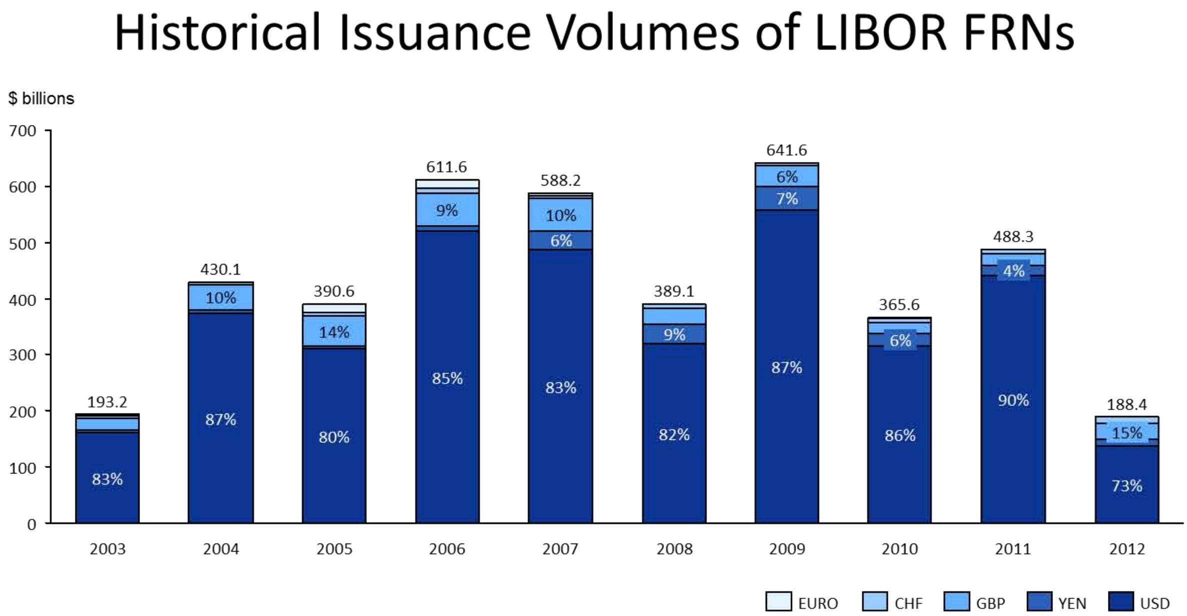
Akin to the illustration provided by Chart 2.C in the discussion paper, the ICMA has analysed this total outstanding amount of LIBOR based FRNs, by currency and by LIBOR tenor (amounts in currencies and tenors not shown are insignificant):

	1m	3m	6m	12m	Total
USD	12%	66%	5%	0%	82%
GBP	0%	6%	0%	0%	6%
EURO	0%	1%	0%	0%	1%
CHF	0%	2%	0%	0%	2%
YEN	0%	6%	2%	0%	9%
Total	12%	81%	7%	0%	100%

Considering this population of currently outstanding LIBOR based FRNs, the ICMA has reviewed the maturity dates of the transactions to identify how much of the aggregate $1.5tn will still have a future maturity date as at the end of each year to the end of the decade:



Complementary to the above analysis of currently outstanding LIBOR based FRNs, the ICMA has also interrogated Dealogic to identify LIBOR FRN issuance volumes over the past decade. This shows the following evolution:



Investment Management Association

7 September 2012

The Wheatley Review
HM Treasury
1 Horse Guards Road
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SW1A 2HQ

By e-mail to: wheatleyreview@hmtreasury.gsi.gov.uk

Dear Sir

The Wheatley Review of LIBOR

The IMA represents the asset management industry operating in the UK. Our Members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of £4.2 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our Members represent 99% of funds under management in UK-authorised investment funds (i.e. unit trusts and open-ended investment companies). The IMA's authoritative Asset Management Survey 2012 recorded that IMA member firms were managing 38% of the domestic equity market for clients.

We welcome the opportunity to comment on the discussion and proposals made in your paper. Our answers to specific questions are attached below.

In general though, we would strongly prefer the correction of the current deficiencies in LIBOR over a solution that requires any transition or migration to other benchmarks. This will involve the wholesale re-organisation of the governance of LIBOR, placing the regulator at the heart of the process. International co-ordination on this and similar pieces of work is vital, given the international nature of financial services (IOSCO, EU Parliament, Commission and HMT).

We look forward to hearing from you if there is any clarification that you would find useful on the points we have raised. We would be happy to meet to discuss the thinking behind the market disclosure requirements.

Yours sincerely

Adrian Hood
Regulatory Adviser

The Wheatley Review of LIBOR

Chapter 2: Issues and failings with LIBOR

Do you agree with our analysis of the issues and failings of LIBOR?

The IMA generally agrees with the analysis set out.

Chapter 3: Strengthening LIBOR

Can LIBOR be strengthened is such a way that it can remain a credible benchmark?

Yes. We believe that it is essential that the identified deficiencies in LIBOR be corrected promptly and robustly, to restore the confidence of the market in this key benchmark.

We would agree that anonymising the submissions to LIBOR would negate the stigma effect of having to report high interest rates.

We would also support making the submission of rates compulsory for all significant banks.

We would also expect increased transparency of process, in terms of membership of LIBOR and minutes of meetings, even if delayed (as for the MPC).

A robust Code of Conduct for those firms and individuals involved in submissions will be necessary, but will depend, for its effectiveness, on credible oversight and supervision by the regulators.

Regulators could require those involved in the submission process, both senior managers and those individuals responsible for making the submissions, or at the very least, those in an oversight function, to be Approved Persons. Individuals may not be client facing, but they could have a significant influence on the firm, if they incur multi-million pound fines. They may also need to be caught by the Remuneration Code.

Could a hybrid methodology for calculating LIBOR work effectively?

If, by hybrid methodology is meant the corroboration of subjective submissions by a trade reporting mechanism, then the trade reporting mechanism would need to be comprehensive and compulsory.

Trades to be reported would need to be only those that met a narrowly defined set of transactions, consistent with LIBOR, and thus it would be easy for firms to carry out any necessary borrowing on such terms that it was not reportable, if they so wished. There would also need to be controls to prevent, or identify where, firms conduct trades away from true market prices, in order to corroborate a false report.

Could the number of maturities and currencies currently covered by the LIBOR benchmark be reduced?

Yes. Our members only use the most active currencies, and maturities, so there is considerable scope of reducing the number of bot these elements, allowing reporting firms to concentrate on the most actively used sectors.

Is an alternative governance body for LIBOR required in the short term?

Given that the LIBOR scandal has caused significant reputational damage to the London Market, appointing a governance body in the short term would demonstrate that the UK authorities are taking action, particularly given that revisions to the European Market Abuse Regime are unlikely to come into effect before 2015.

The only realistic option would be for the regulator to take over this role.

Should the setting of and/or the submission to LIBOR be regulated activities?

Yes. Given recent developments this is now seems both inevitable and necessary.

Regulator of submission of data should be a regulated activity, and the regulator should also oversee the process of calculation, receiving error-reports from the body conducting the calculation of the rate.

As we have said above, regulators could require those involved in the submission process, both senior managers and those individuals responsible for making the submissions, or at the very least, those in an oversight function, to be Approved Persons. Individuals may not be client facing, but they could have a significant influence on the firm, if they incur multi-million pound fines. They may also need to be caught by the Remuneration Code.

Should the regulator be provided with specific powers of criminal investigation and prosecution in relation to attempted manipulation and manipulation of LIBOR?

We note that the current regulator, using its current powers managed to fine Barclays £60m for manipulating LIBOR rates. Fines, and the ability to ban individuals from working in the industry, are significant deterrents.

We would not support a rush to impose new criminal offences, particularly the suggested broadening of s397 of FSMA, which would, potentially and unintentionally, criminalise a wide swatch of activities unrelated to LIBOR or other benchmarks.

While it is important that the governance of LIBOR be improved quickly, we do not see any such urgency with respect to revising related criminal powers. Any amendments should be thoroughly considered and consulted on, so that all options are thought through and unintended consequences avoided.

Given that MAR is coming in by 2015, and that the UK may well opt in to CSMAD, these should grant regulators the criminal powers and offences they would need. Should the regulator be given extra criminal powers for the time until MAR is implemented, then these should be subject to a 'sunset' clause, so as to expire once the European offences come into force.

What role should authorities play in reforming the mechanism and governance of LIBOR?

While LIBOR is a creation of the industry, serving a perceived need of the market, the regulator should ensure that it does so in a fair, consistent and robust manner, to maintain market confidence.

Regulators should satisfy themselves that the mechanism and governance is robust and this should be subject to review to confirm this. Those calculating the rate should be required to error report.

Which types of financial contract, if any, would be particularly affected by the risks of a transition from LIBOR?

The key point is to get the governance around LIBOR right.

Any move to an alternative benchmark could be subject to a similar potential for manipulation unless effective governance arrangements are applied to that alternative. Our preference is to stick with LIBOR as there is, otherwise, a danger of market fragmentation by a move to one, or number of, alternatives and any transition could be a very painful, disruptive and expensive process. It is essential that regulators do not frustrate existing legal contracts.

Chapter 4: Alternatives to LIBOR

Are there credible alternative benchmarks that could replace LIBOR's role in the financial markets?

SONIA could be used to an extent, but it does not adequately reproduce all the characteristics of LIBOR which have made it such a popular benchmark.

Should an alternative benchmark fully replace LIBOR, or should it substitute for LIBOR in particular circumstances?

No. Every effort should be made to reform LIBOR.

As the discussion paper has identified, numerous alternatives exist. The market has identified LIBOR as the most appropriate for most purposes.

Regulators should ensure that there are no artificial impediments to alternatives being developed or used. It is not up to them to promote or mandate these alternatives; it is up to the market to decide which are useful and trustworthy.

Should particular benchmarks be mandated for specific activities?

No.

Over what time period could an alternative to LIBOR be introduced?

As indicated above, out preference is not to move to an alternative, but to reform LIBOR.

Should any such transition be required, it would be necessary for considerable time to be provided for the process, noting that firms would need to renegotiate their contracts and revamp all their marketing literature.

What role should authorities play in developing and promoting alternatives to LIBOR?

Regulators should merely ensure that there are no artificial impediments to alternatives being developed or used. It is not up to them to promote or mandate these alternatives; it is up to the market to decide which are useful and trustworthy.

Chapter 5: Potential implications on other benchmarks

Are there other important markets or benchmarks that could face similar issues to those identified relating to LIBOR?

No comments

Should there be an overarching framework for key international reference rates?

Given that there are several different bodies looking at benchmarks internationally it would be helpful for this process to be coordinated at an international level, to avoid a patchwork of regulation, as we are seeing with other proposals.

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The Wheatley Review
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7 Sept 2012

Response from the International Swaps and Derivatives Association Inc. ("ISDA") to the Wheatley Review of Libor initial discussion paper.

Dear Sirs,

ISDA represents a broad global range of over 800 OTC derivatives market participants including corporations, pension funds, insurance institutions, asset managers and other investment companies, energy and commodities firms, clearing houses, government and supranational entities, as well as global and regional banks, and is very pleased to have the opportunity to respond to the discussion paper. Since the inception of OTC derivatives in the 1980s, its members have referenced Libor rates as the floating rate in the majority of their interest rate transactions. ISDA views itself and its membership as being a user of the rate, as published.

We are keenly interested in the integrity of Libor, but ISDA does not have any direct responsibility for the governance, management, constitution or methodology of Libor. As such, we will not be answering in any detail the Review's questions which pertain to matters such as these. Equally, we will not address considerations of possible alternatives or successors to Libor (either generically or specifically) in the case that the ultimate decision is reached that Libor should be discontinued. Our responses to selected questions where ISDA does have a comment can be found in full in the accompanying Appendix.

Overall, ISDA believes that economically Libor continues to be hugely relevant to, and necessary for the proper functioning of, the OTC derivatives market. Total notional swap outstandings that reference a Libor rate are estimated to be $300Tn, replacing Libor as a reference rate for these swaps would be a very significant undertaking.

ISDA fully recognises the importance of "reforming" Libor in terms of its governance and transparency of process and data etc, but certainly does not support its discontinuation. We are encouraged that the authorities recognise that they may well have a role to play in encouraging firms to continue contributing to Libor in a climate where perceived cost and risk concerns may be disincentivising future participation. This may become an important role for the authorities over the short to medium term. Any disruption to the Libor process could result in market turmoil of systemic proportions.

ISDA® Safe, Efficient Markets

We have pleasure in submitting our response, and look forward to staying very much engaged with members of the review team as its work moves forward towards conclusion.

Yours faithfully,

Robert Pickel
Chief Executive Officer

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Appendix – Responses to selected Consultation questions, in italics.

Chapter 2: Issues and failings with LIBOR

Do you agree with our analysis of the issues and failings of LIBOR?

Chapter 3: Strengthening LIBOR

Can LIBOR be strengthened in such a way that it can remain a credible benchmark?

Could a hybrid methodology for calculating LIBOR work effectively?

At a high level with regard to methodology, we generally support the use of actual trade data (where available) in Libor's compilation (which was always the case before interbank lending volumes fell away during and after the financial crisis). At the same time, we acknowledge that it will likely still be necessary to deploy algorithms or expert judgement to fill the gaps where no trade data exists. In fact, we would argue that expert judgment still plays a part even where actual trade data exists, given that the decision to transact the trade(s) depends upon the exercise of such expert judgement. Clearly work needs to be done to enhance the governance and transparency of Libor, but perhaps little more beyond that. Of note is that we have not heard from any sections of our membership that they believe that Libor should be re-engineered.

Could the number of maturities and currencies currently covered by the LIBOR benchmark be reduced?

We offer no opinion as to the appropriateness or desirability of reducing the number of Libor tenors and / or currencies but would draw attention to our comments below in respect of the likely impact of the package of changes to tenors and currencies that we believe to have been tentatively agreed.

Is an alternative governance body for LIBOR required in the short term?

Should the setting of and/or the submission to LIBOR be regulated activities?

Should the regulator be provided with specific powers of criminal investigation and prosecution in relation to attempted manipulation and manipulation of LIBOR?

What role should authorities play in reforming the mechanism and governance of LIBOR?

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Which types of financial contract, if any, would be particularly affected by the risks of a transition from LIBOR?

As the trade association for OTC derivative products, our comments below relate solely to those products, whilst recognising that changes to Libor or a transition away from it will also impact other products in other markets which often underlie OTC derivatives transactions. Within the OTC derivatives markets, interest rate derivatives are the most heavily impacted asset class. We offer some detailed analysis of how trades might be affected by changes to or a move from Libor, according to the terms of their ISDA documentation and in the wider context of incident legal risk.

The majority of OTC interest derivatives transactions use Libor rates as the reference rate for floating legs of transactions. These transactions are typically documented under an ISDA Master Agreement and a trade Confirmation, which will reference the relevant published ISDA Definitions. The Definitions give formal and detailed descriptions for all of a transaction's variables that will be referenced in the trade Confirmation. In other words, the Definitions remove the need to restate the often lengthy descriptions of commonly-used trade attributes in Confirmations. This has an important risk reducing effect in that it enables rapid (often electronic) turnaround times, given that the Confirmations can be brief in that they refer to, rather than restate the Definitions. The main operative booklet of definitions with respect to Libor is the "2006 ISDA Definitions". In essence the definitions of Libor rates are very much page-driven, by which we mean that the rate for (say) GBP Libor is defined as being the rate that appears on Reuters screen LIBOR01 (or an equivalent page in the case of the Bloomberg definition). Defining the rates in this way means that the Definition should be able to accommodate a certain amount of change to the rate in terms of methodology of compilation, for instance, so long as the rate still appears on the given page. Clearly, however, there are limits to this and as changes become more economically significant, and to the extent that Libor is fundamentally changed into something else (even if its description does not change and even if it continues to fall within the strict wording of the definition), so the risk increases that parties may claim, under doctrines of frustration or otherwise, that the contract is not what they bargained for. (see below). The definition provides that where the rate is not published at all, parties will revert to the polling of specified numbers of so-called "Reference Banks" to arrive at a rate themselves.

In respect of the large "back book" of transactions, we offer now a description of how these definitions would "cope with" changes to scope or method Libor or to its disappearance. In practice the effects of any changes would be in proportion to the significance of such changes. We understand that the BBA had, prior to recent events, long been considering changes to Libor that would have included the deletion of certain currencies and tenors. We believe these changes were on the point of being put out to public consultation. As to the currencies, the discontinuation (over time) of the AUD, CAD, DKK, NZD and SEK Libor rates has been and continues to be proposed. Of these 5 currencies, ISDA only published definitions for the AUD and CAD rates. Parties using any of the other 3 rates will presumably have had to define these rates in their own bespoke documentation and would need to act in accordance with its terms in the event of discontinuation. That said, we would suspect that trade volumes here would be very low. With respect to AUD and CAD, data from the DTCC Global Trade Repository indicates there is only a handful of extant trades, meaning that the Reference Banks fall-back should work effectively ie that firms should be able to conduct polls, albeit manually, in order to calculate a rate.

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Regarding Libor's tenors, uncertainty persists as to the future of the 12 and 6 month tenors. It should be noted that many hundreds of thousands of Libor-referencing trades, perhaps in excess of 40% of the entire Libor-referencing trade population, use the 6 month tenor. If the 6 month tenor were to be stopped, or indeed Libor were to be totally discontinued significant levels of market disruption would be introduced, given that the Reference Banks mechanism would come under strain and may not be workable in practice. This is because of the sheer number of Reference Bank polls which would need to be conducted. The party responsible for conducting the poll in respect of an affected trade is the Calculation Agent (as defined in the 2006 Definitions) and specified in the trade Confirmation. Typically in customer trades, the bank party would be the nominated Calculation Agent, however in interbank trades often provision is made for co-Calculation Agents. On any given day the Calculation Agent(s) in respect of every trade resetting against an affected Libor rate will need to conduct a poll in respect of thot rate. An initial obstacle here in the interbank market will be that the parties will need to agree upon which Reference Banks to approach. Once agreed, polling can take place, however it is possible that strictly speaking thousands of polls may need to be conducted on a trade by trade basis and it is highly unlikely the market could support this burden of activity. Even if all the polls were conducted in a timely and orderly manner, each would yield a different result. This would mean that a party with (soy) 2 GBP Libor resetting trades with 2 banks would see those trades reset at different levels.

Changes would be required to the standard ISDA documentation to give effect to changes, once their details were known, or to address the consequences of the outright discontinuation of Libor, both in respect of the "back book" of legacy trades and to cover new trades on a going forward basis. The market would need to migrate to a successor rate or rates (pre-existing or otherwise) in respect of each Libor rate that was discontinued, be that a more minor rate such as AUD or a majar one such as GBP. ISDA could publish Supplements to its Definitions to facilitate changes to contracts necessary to reference any newly-published successor rates. To facilitate the use of successors in legacy trades, ISDA would likely publish a Protocol which would have the effect of amending OTC derivatives contracts between adhering parties so as to convert their back book trades to reference the agreed successors. It would be absolutely vital to have clear ond long term transition arrangements in place, given that the market will take time to migrate liquidity to new rates. It is important to note that adherence to an ISDA Protocol is entirely voluntary, and market participants will only adhere if they perceive that it is in their interest to do so. For the Protocol to be as effective as possible a significant period of time is required so that as many market participants as possible can participate, and can have the opportunity to do so as they see liquidity migrating to the new rate sources. Without such transition arrangements, the ensuing market disruption could be potentially unmanageable. Again, we are pleased that the discussion paper acknowledges the need for any transition to be carefully planned and managed.

We have mentioned the risk of claims of contractual frustration a number of times, and now turn to cover this in more detail in the context of OTC derivatives portfolios covered by English law-governed ISDA Master Agreements. As suggested above, there is likely to be something of a continuum from minor changes that could most likely still be regarded as falling within the existing definitions of the floating rates, through to more significant changes that could lead some market participants to claim under doctrines of contractual frustration or otherwise, that the nature of their contract had changed

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fundamentally from what they had originally intended. It is certainly unclear at which point one becomes the other, and we hope that changes could be managed in such a way that it is not tested. Under the English law doctrine of frustration a contract may be discharged if broadly speaking, after its formation supervening events occur which have the effect of either (i) frustrating the contract's commercial object or purpose or (ii) making its performance impossible. It is unclear whether major changes to Libor, or its discontinuation, would be grounds for a valid claim of frustration or under some other doctrine but it will be clear those changes to or discontinuation of a rate potentially brings us into this territory and indeed some of the decided cases touch on these very points. As mentioned above, the 2006 ISDA Definitions provide a fall-back to Reference Bank polling in the event that a given rate disappears from a page, so to a degree direct contractual provision has been made for the eventuality of Libor's discontinuation. On the other hand, as noted above, that fall-back might not prove workable in practice. We believe that there is a risk that discontinuation of Libor or changes other than those that are clearly economically immaterial to its calculation, could give grounds for claims of contractual frustration. We urge the authorities to bear this in mind as they contemplate the future of Libor, both in its current form or some other, in order to avoid the major market disruption that the uncertainty of any such claims would cause.

Additional analysis would be required to assess the risk of claims under doctrines such as contractual frustration (or any local equivalent) in respect of ISDA Master Agreements governed by anything other than English law. We understand that concerns similar to those noted above could arise under New York law. New York or English law is the governing law for most OTC derivatives contracts.

Chapter 4: Alternatives to LIBOR

Are there credible alternative benchmarks that could replace LIBOR's role n the financial markets?

Should an alternative benchmark fully replace LIBOR, or should it substitute for LIBOR in particular circumstances?

Should particular benchmarks be mandated for specific activities?

Over what time period could an alternative to LIBOR be introduced?

Please see our comments above as to the need for there to be clear and long term arrangements in place for the management of any transition. Failure to achieve a smooth and progressive transition will result in major market dislocation and significant "jump risk" if there is an abrupt move from Libor to a successor. The rate of any transition will likely be chiefly determined by the speed of migration to an alternative in terms of liquidity as well the extent to which market participants have amended their documentation (along the lines suggested above) to embrace such transition.

What role should authorities play in developing and promoting alternatives to LIBOR?

Chapter 5: Potential implications on other benchmarks

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Are there other important markets or benchmarks that could face similar issues to those identified relating to LIBOR?

Relevant in the consideration of benchmarks more broadly, and for completeness, we offer here a brief description of ISDA's own suite of swap prices, ISDAFIX. More detailed information is available on www.ISDA.org.

- *Swap rate mid prices for 6 currencies (EUR, USD, GBP, CHF, HKD and JPY) with multiple tenors to 30 years published daily or twice-daily in some cases.*
- *Established in 1998 in cooperation with Thomson Reuters and ICAP.*
- *Thomson Reuters (ICAP in the case of USD) collect contributions from each currency panel. Topping and tailing is undertaken, with the remainder being averaged to give the rate.*
- *ISDAFIX is currently published on Thomson Reuters, Bloomberg and Telekurs, with individual contributions being available too.*
- *The rate is used in the professional markets, mainly for the valuation of cash-settled swaptions and early terminations.*
- *Historical data is available.*

Should there be an overarching framework for key international reference rates?