EVOLUTION OF ICE LIBOR FEEDBACK STATEMENT

1. Introduction

On 20 October 2014, ICE Benchmark Administration Limited ("IBA") published a Position Paper outlining:

- our findings in administering ICE LIBOR since we assumed responsibility on 3 February 2014
- our response to the report published on 22 July 2014 by the Financial Stability Board ("FSB") on its proposed reforms for major interest rate benchmarks[1], which included as an overarching objective, the transition to rates anchored in transactions where possible
- our proposed enhancements to elements of ICE LIBOR
- an initial request for views on the proposed enhancements and 'Questionnaire on LIBOR usage'.

The Position Paper was distributed widely, to all LIBOR Licence holders as well as other major stakeholders – in total there were more than 600 recipients. A media release was issued to launch the consultation and the Position Paper was published on IBA's website.

The Position Paper invited feedback on IBA's proposals by 19 December 2014. It can be found at:

https://www.theice.com/publicdocs/ICE_LIBOR_Position_Paper.pdf

Since December, bilateral and round table meetings have been held to discuss the proposals further, as follows:

- Zurich on 29 January 2015 hosted by the Swiss National Bank
- New York on 19 February 2015 hosted by the Board of Governors of the Federal Reserve and the Federal Reserve Bank of New York
- Tokyo on 24 February 2015 hosted by the Bank of Japan
- London on 10 March 2015 hosted by the Bank of England, and
- Paris on 16 April 2015 hosted by the Banque de France.

[1] See http://www.financialstabilityboard.org/publications/r_140722.pdf

We are grateful for the views received on the Position Paper and in response to the consultation. Appendix 1 sets out a list of organisations that responded to the consultation, attended a round table meeting and/or provided bilateral feedback to IBA.

We would like to thank regulatory authorities and central banks for their continued engagement and support in the evolution of LIBOR, and in particular the following: the Financial Conduct Authority (FCA); the Bank of England; the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York; the Swiss National Bank; the Bank of Japan; the Japan Financial Services Agency; the European Central Bank; the International Organization of Securities Commissions (IOSCO); and the Banque de France.

In this feedback statement, we provide a summary of the feedback received in relation to the Position Paper and accompanying questionnaire on the usage of LIBOR in specific currencies and tenors.

The two fundamental objectives of IBA's proposed enhancements in the Position Paper are:

- to create a single, clear, comprehensive and robust LIBOR definition, and
- to implement a construct for ensuring the rate can adapt to changing market conditions with appropriate consideration for the interests of all stakeholders.

2. Summary of Proposals in the Position Paper

As set out in the Position Paper, the following principles underpin IBA's proposals for the evolution of LIBOR:

- Users need to understand LIBOR and over-complexity would not enhance the benchmark's credibility
- Submission criteria should be transparent and objective whilst avoiding unnecessary complexity in setting standardised parameters
- Implementing a more transaction-based approach for determining LIBOR submissions may require a different solution depending on the currency and tenor and the market dynamics. However, the solutions must be coherent across currencies and tenors in order to minimise both the transition risk and the time needed to deliver the enhanced approach
- consistency and reliability of data are key success criteria, and
- the evolution construct must ensure that LIBOR can adapt to changing market conditions.

The three LIBOR elements – the name, daily question and market practice - should be more explicitly documented so that the methodology, processes, fall-backs and other practices are more transparent to stakeholders.

IBA's Position Paper set out key aspects of our proposals:

- basing LIBOR on transactions where there is adequate activity
- having a waterfall of methodologies for submissions
- expanding the range of counterparties to include large wholesale counterparties (including, for example, Sovereign Wealth Funds and Money Market Funds and large corporates)
- expanding the range of transactions
- standardising parameters for transactions (eg eligible transaction sizes and treatment of transactions with non-standard tenors)
- standardising interpolation and extrapolation techniques, and
- framing Expert Judgment.

The Position Paper also considered a number of other aspects of LIBOR:

- whether LIBOR should continue to be calculated using a trimmed mean where the highest and lowest 25% of submissions are excluded
- whether the submission from each contributing bank should continue to be weighted equally in the LIBOR calculation methodology, and
- whether the number of panel banks submitting for each currency should and could be expanded.

3. Feedback

i) <u>Basing LIBOR on transactions</u>

The proposals in IBA's Position Paper were, in summary, as follows:

- evolving LIBOR to be a rate based on transactions as far as possible, and
- having a waterfall of calculation methodologies in order to ensure that LIBOR rates can always be made available, even in times of market stress and / or illiquidity.

Respondents were supportive of the proposed approach, agreeing that LIBOR should be based on transactions as far as possible and that the pool of available transactions should be widened. LIBOR Panel Banks were especially supportive of a defined and consistent methodology in order to minimise their operational and regulatory risk. Banks also mentioned that the nature of the funding market has evolved and LIBOR needs to change to reflect this. Regulatory requirements such as Basel III and LCR are also changing the make-up of bank funding and the Liquidity Coverage Ratio (LCR), in particular, is causing banks to secure longer term funding than they might otherwise.

Respondents appreciated that, in making enhancements to LIBOR, it will be important to avoid creating a situation where contracts have to be renegotiated or tax and accounting implications arise.

Volatility was a topic which elicited much discussion at the round table meetings. Several respondents acknowledged that only allowing Expert Judgment when there are insufficient transactions could increase volatility. A concern about increased reset risk and hedging costs was voiced by several people and especially for commercial contracts that refer to month end rates that may prove the most volatile. A broad consensus took the view that greater volatility should not itself be regarded as problematic provided that it was indeed a reflection of the underlying market conditions and was not just indicative of 'noise'.

ii) Having a waterfall of methodologies

Overall, the feedback on the proposals in the Position Paper has given us no reason to question the strategic evolutionary direction for LIBOR, with its overarching methodology spanning:

1. Transactions, to be used exclusively where sufficiently available, then

2. Derived from transactions, including interpolation and extrapolation (using formulae defined by IBA), 'parallel shifts' where a bank has some adjacent tenor points and potentially FX conversions, then

3. Expert Judgment, appropriately outlined to make it as verifiable as possible. In addition, building the existing waterfall in Box 4.B of the Wheatley Review which includes banks' observations of third party transactions and quotes by third parties to contributing banks.

IBA's proposals focused on:

- having banks' submissions based on interpolation / extrapolation and 'other conversions' where appropriate if the number of transactions for a tenor is not sufficient for determining a submission, and

- limiting banks' use of Expert Judgement to when their transactions for a tenor are not sufficient and interpolation / extrapolation and 'other conversions' are not appropriate.

A waterfall methodology was supported by respondents provided that a robust framework and defined parameters underpin the approach.

At a round table meeting one attendee mentioned transparency of the rate would also be improved if the percentage of submission types in the waterfall for each rate were also published.

One respondent queried how a trade at an unrepresentative price would be handled. Banks' methodologies could now exclude such transactions from the computation; this involves the exercise of some Expert Judgment which banks are understandably keen to avoid because of the additional regulatory risk associated with using data that is not clearly auditable. Some respondents considered that an overlay of Expert Judgement is almost inevitable to ensure appropriate submissions, citing occasions where even an ample sufficiency of transactions would not yield a good submission if there had been strong market move or political happenings in the period between the collection by a bank of its transactional data and the submission of its LIBOR rates to IBA.

LIBOR users at round table meetings thought that a rate based on Expert Judgment should not be classed as “inferior” to a transaction based rate.

IBA is conducting a detailed analysis of data from LIBOR benchmark submitters and we are seeking to identify the extent to which increased volatility could reflect ‘noise’. We will publish results from the analysis in the Summer of 2015 after having consulted with the official sector.

iii) Expanding the range of counterparties

IBA proposed expanding the range of counterparties with a view to including not just inter-bank trades but also trades from the wholesale market such as with central banks, sovereign wealth funds, financial institutions and / or large corporates.

There was broad agreement with the comment in the Position Paper that “to be consistent with the original purpose of LIBOR and to reflect the changes in bank funding in recent years, all wholesale and professional entities should be regarded as eligible counterparty types, including central banks and large corporates.”

Extending the range of counterparties was seen as a sensible and necessary measure for increasing the volume of transactions to underpin LIBOR submissions.

Although it was not the majority opinion, a number of respondents voiced a concern that including large corporates as counterparties could lead to a change in the credit element of LIBOR, for two reasons. First, large corporates’ transaction sizes may be smaller than interbank trades have traditionally been and, second, the pricing may differ from interbank dealings.

A related comment voiced more than once was that the inclusion of corporates as counterparties is debatable because of different pricing considerations and LCR implications.

Another comment made several times was that including corporates is a natural evolution of LIBOR as it reflects the changing profile of banks' means of funding. It was also noted at one round table meeting that not all 'interbank' transactions should be included within the calculation of submissions - a minimum credit standing for wholesale counterparties could be specified by IBA.

iv) Expanding the eligible transactions

IBA’s Position Paper referred to ways of expanding the range and volume of transactions by:

- including in banks’ submissions the transactions from all primary funding centres in which the bank operates (and so including on-shore as well as off-shore trades), and

- making banks' LIBOR submissions based on transactions booked since their LIBOR submission on the previous business day.

The proposal in the Position Paper that yielded some of the most feedback was that benchmark submitters should include all of their eligible transactions since their LIBOR submission on the previous business day in order to allow the benchmark to be anchored as far as possible in transactions. However, some suggested that transactions at the close of business to square accounts would not be a reliable input in informing the LIBOR submissions.

Some benchmark submitters voiced concern that using funding centres outside London would further increase the complexity, cost, legal and operational risk associated with submitting to LIBOR, potentially requiring approval from local regulators for transactions to be used.

One respondent commented that LIBOR was developed as an offshore euro-currency rate. Although onshore and offshore rates may be similar in flat markets, this is not the case in times of stress. Another comment, made more than once, was that rates differ according to location and that the nature of LIBOR might be adversely affected if the funding locations were widened significantly. Another observation was that LIBOR is a global benchmark and that transactions in other centres are as pertinent as those in London. This would highlight the importance of agreeing funding centres with IBA to ensure a consistency of approach.

The Position Paper noted that even after broadening the range of eligible trades, there may be insufficient transactions for a submission across all tenors. Respondents generally recognised this and agreed that expanding the range and volume of transactions is therefore needed as part of the evolution of LIBOR.

There was general support for the primary transaction types to be used in submissions – unsecured Term Deposits (TD), primary issuance Certificates of Deposit (CD) and Commercial Paper (CP). These are already being used in submissions in accordance with submission guidelines in the Wheatley Review and in the LIBOR Code of Conduct.

The Position Paper further proposed other transaction types, such as Overnight Index Swaps (OIS), Repos, FX Forwards, Forward Rate Agreements (FRAs) and Floating Rate Notes (FRNs) should only be included when a bank's lack of direct transactions means that the submitter has to rely on expert judgement.

One commentator queried the inclusion of Commercial Paper because different pricing considerations apply. It was suggested that, being tradeable instruments, CP have fundamentally different characteristics from bilateral loans.

Some concern was expressed that the use of further transaction types could introduce pricing differentials and would not reflect the wholesale unsecured funding market.

Transactions in the OIS, Repos and FRAs markets were generally not recommended to be included since they are by nature derivatives and not financing products. Collateralisation and other implications were also cited. IBA recognises these limitations and, as proposed in the Position Paper, we would regard these instrument types as being helpful in framing expert judgment but not as transactions on which to base submissions.

Also, as the Market Participants Group Report[2] stated, FX implied rates are not appropriate as there are many variables that can bias the result (for example, credit, convertibility and liquidity) and in periods of stress they fail to represent liquidity pricing. It was noted in the round table discussions that FX trading may just be carried out for balance sheet purposes and not reflect funding. Therefore including FX trades would require judgement to be applied by banks as to which are relevant for a submission.

Repo and other collateralised trades cannot be used as a proxy for unsecured funding. However, a combination of the borrowing cost in the base currency and a firm FX swap price may be very close to a true funding transaction.

Interest Rate Futures were proposed as a possible additional transaction type to provide liquidity particularly in short- dated tenors.

Some concern was voiced about the influence of idiosyncratic factors. Whilst we believe that this concern should be allayed if there are sufficient transactions, we would welcome any further comments on this.

One respondent commented that a move away from unsecured funding sources would not be helpful as part of the waterfall since transactions tend to be on a secured basis in time of stress – just when the credit element is most important. IBA agrees that using unsecured funding data is important to LIBOR.

It was also suggested more than once that banks should submit transactions rather than submissions to IBA and that IBA should calculate LIBOR from the transaction pool. This is a development that we are considering as part of the longer-term evolutionary strategy for LIBOR.

A recurring theme was that an obvious way of increasing the number of transactions would be to expand the number of banks contributing to LIBOR. There is undeniable logic to this proposition but, whilst IBA would be very keen to expand the panels, it is not within our powers to do so. As stated in the Wheatley Review:

"5.22 While the benefits of LIBOR are enjoyed by all banks (and a large number of other market participants), only a small group of banks contribute to the benchmark, and there are some notable large banks that do not participate in the LIBOR panels.

5.23 In the [FCA] discussion paper[3], the Wheatley Review noted that large panel sizes would benefit the accuracy and credibility of the benchmark. This was reflected in the consultation process, where many respondents supported large panels of submitting banks. There were two main reasons cited for ensuring large panel sizes.

- large panels ensure that individual submissions have a limited impact on the published benchmark. Thus wider panels discourage attempts to manipulate LIBOR; and

[2] The MPG report can be found at http://www.financialstabilityboard.org/publications/r_140722b.pdf

[3] On 10 August 2012, the Wheatley Review published a discussion paper which can be found at http://www.hm-treasury.gov.uk/wheatley_review.htm.

- an increase in the number of contributors could increase the overall representativeness of the LIBOR benchmark."

Some respondents commented that expansion of the panels should not be to the detriment of the credit standing exhibited by the current LIBOR panels. We believe that a reasonably modest expansion could be effected without undue dilution.

Discussions at round tables on increasing the number of panel banks mentioned the possibility that new banks could become LIBOR submitters and just submit transactions for certain currencies where they have liquidity, leaving the exercise of Expert Judgment to the established panel banks.

The comment was also made that evolution of LIBOR must take into account regulatory developments such as, for example the impact on banks of ring-fencing. IBA are in discussion with FCA and PRA regarding ring-fencing developments and impact on submitting banks.

v) Standardising parameters for transactions

IBA's proposals included a number of measures to standardise the parameters used by banks in determining their submissions. As stated in the Position Paper, benchmark submitters already use a wide range of transactions to anchor their LIBOR submissions within the existing waterfall of methodologies in Box 4.B of the Wheatley Review. Each benchmark submitter has developed its own methodology for establishing LIBOR submissions and a variety of approaches now exists.

IBA's proposals for standardising transaction parameters were to:

- specify the acceptable market size for transactions to be included in banks' LIBOR submissions
- set a matrix of minimum aggregated volumes for submissions for each currency and tenor, and
- set a standard method for the inclusion of transactions which are not of a standard maturity (for example how to treat a 4 month trade as the adjacent LIBOR tenors are 3 months and 6 months).

Timing of transactions:

The Position Paper proposed that submitters should include all of their eligible transactions since their LIBOR submission on the previous day. Also, that it may be appropriate to apply weightings according to when transactions were executed.

Comments included;

- Submissions would be less susceptible to manipulation if the time period were longer and without the current focus on 11:00 rates
- Time zones in which banks fund themselves will be increasingly important
- Markets can move quickly, making transactions from the previous day less relevant

- Volatility would be increased, particularly over month ends
- Moving the LIBOR setting time back by a short period (perhaps one or two hours) would allow more USD trades to be included
- Weightings should be added depending on the transaction time, and
- Market events may require the exercise of Expert Judgment.

In regard to the submission window, the practical and pragmatic benefits of using transactions from the entire preceding business day were agreed, whilst it was acknowledged that this might cause LIBOR to become less useful as an indicator of interest rates as of a particular moment in time. There is a balance to be struck between, on the one hand, increasing the set of eligible transaction data for LIBOR submissions through an expanded data-collection window and, on the other hand, producing an interest rate benchmark that reflects current market conditions to the greatest extent possible.

A recurring comment was that, in the event of a long window (for example, over Easter), weightings should be set so that transactions earlier in the 'transaction window' should have a lower influence on submissions than late ones. We will include questions in our later consultation to explore this further.

Standardising parameters

The Position Paper proposed using standard formulae for interpolation and extrapolation, as specified by IBA.

The proposal to set clear guidelines in order to remove ambiguity was welcomed.

However, one respondent noted that an element of Expert Judgment in interpolation could still be required to deal with month/quarter ends and with market events.

In the waterfall of methodologies, it is worth emphasising that a bank's transactions, albeit that they may be insufficient in themselves for determining the bank's LIBOR submission, need to be taken into account in conjunction with interpolation and extrapolation (and, as appropriate, with the use of Expert Judgment).

We are working on a range of standardising parameters, including minimum wholesale sizes of transactions and minimum aggregated transaction volumes to support a submission. These parameters will form a key part of our further consultation in the Summer of 2015.

One suggestion was that the eligible transaction size for each panel bank should be agreed bilaterally between the banks and IBA and that IBA should then publish the median of the eligible transaction sizes.

Calculation methodology

Several respondents commented on the calculation methodology:

- Trimming of submissions would not generally be recommended for a transaction-based rate but eliminating extreme submissions, which may be erroneous, should still be carried out

- Trimming based on 5% from median would be problematic in a small market and 5% in a 5% interest rate market would be 25bp. Standard deviations from the mode could be used but could be unreliable in small populations

- Smoothing should not be applied as volatility in the market should be reflected and goes with ideology of transaction based approach, and

- Volatility may increase in times of market stress but using a median in calculation could reduce this.

One suggestion was that, as a possible alternative or complement to 'topping and tailing', IBA should consider excluding submissions based on Expert Judgment if sufficient other submissions for that particular LIBOR rate are based on transactions (either directly or by means of interpolation). This would suggest as a prerequisite a minimum number of submitters and/or transactions and could be predicated on increasing the size of currency panels.

Our next consultation paper will present a number of calculation scenarios.

vi) Data embargo

The range of comments was:

- The 3 month embargo should remain for named publication of submissions but it would be helpful if data were made available earlier without naming the benchmark submitters, and

- There should be no publication of attributed individual banks' submission data at any time.

In the Position Paper, we invited comments from stakeholders on whether to modify the three-month embargo before the submissions are published.

4. Usage Questionnaire

The Usage Questionnaire that accompanied the Position Paper asked for frequency of use and importance per currency and tenor and also had a free text space. The responses to the Questionnaire provided useful information indicating that all LIBOR currencies and tenors are currently utilised extensively for a variety of purposes – valuations, pricing of loan products, pricing derivatives and swaps, re-setting floating rate instruments and accounting. IBA has no plans to discontinue any LIBOR tenors or currencies.

5. Next steps and further feedback

IBA proposes to launch a formal consultation in Summer 2015 to seek responses to more detailed aspects of our proposals.

In the meantime we welcome any further feedback on the proposals in this paper. Please contact us at:

IBA@theice.com

Or by post to:

ICE Benchmark Administration Limited
Milton Gate
60 Chiswell Street
London. EC1Y 4SA

Please raise any other considerations that you think should be included to further enhance the LIBOR reforms.

6. ICE LIBOR: Frequently Asked Questions:

theice.com/publicdocs/IBA_LIBOR_FAQ.pdf

LIST OF APPENDICES

1 List of organisations that responded to the consultation, attended a round table meeting and/or provided bilateral feedback to IBA

2 LIBOR Evolution FAQs

APPENDIX 1 – CONSULTATION RESPONDENTS

IBA is grateful to the following organisations that responded to the consultation, attended a round table meeting and/or provided bilateral feedback to IBA:

Firm	**Sector**
ACPR	Regulator
Air Liquide	Corporate
Amherst Pierpont Securities	Broker
Amundi	Insurance / Asset / Fund Management
Association Francaise des Tresoriers d'Entreprise (AFTE)	Association
Associates in Capital Markets Ltd (ACAPM)	Consultancy
Association of Corporate Treasurers	Association
Association of Wholesale Market Brokers	Association
Aviva	Insurance / Asset / Fund Management
AXA	Insurance / Asset / Fund Management
Bank of America	Panel bank
Bank of Tokyo-Mitsubishi UFJ	Panel Bank
Barclays	Panel bank
Blackrock	Insurance / Asset / Fund Management
BNP Paribas	Panel bank
bp	Corporate
Brevan Howard US Investment Management	Insurance / Asset / Fund Management
Caisse des Depots	Insurance / Asset / Fund Management
Canada Life	Insurance / Asset / Fund Management
Central Tanshi	Broker
Citi	Panel Bank
Clariant	Corporate
CME Group	Corporate
Commerzbank	Bank
Convexity Capital Management LP	Insurance / Asset / Fund Management
Credit Agricole	Panel bank
Credit Suisse	Panel bank
Daiwa Securities	Securities Company
Deutsche Bank	Panel bank
Doubleline Capital LP	Insurance / Asset / Fund Management
Depository Trust and Clearing Corporation (DTCC)	Clearing House
EDF	Corporate
European Securities and Markets Authority (ESMA)	Association
Experian	Corporate
FCA	Regulator
Federal Home Loan Mortgage Corporation	GSE
Federal National Mortgage Association	GSE
Futures Industry Association (FIA) Global	Association
GDF Suez	Corporate

Gdansk Institute for Market Economics	Academic
GE Electric	Corporate
Givaudan	Corporate
GKN	Corporate
Global Economics Group	Academic
Grosvenor Estates	Corporate
Hamilton Court Capital Limited	Trading Group
Hitachi	Corporate
HSBC	Panel bank
IBM	Corporate
ING UK	Bank
International Capital Markets Association	Association
ISDA	Association
Japan Securities Clearing Corporation	Clearing House
Japanese Bankers Association	Association
Joyo Bank	Bank
JP Morgan	Panel bank
JP Morgan Asset Management	Insurance / Asset / Fund Management
Lafarge	Corporate
Lagardere Group	Corporate
LCH Clearnet	Clearing House
Lloyds	Panel bank
Loan Market Association (LMA)	Association
London Money Market Association (LMMA)	Association
Mitsui & Co.	Corporate
Mizuho Bank	Panel bank
National Futures Association	Association
Nationwide	Building Society
Nomura Securities	Securities Company
Nord LB	Bank
Prudential	Insurance / Asset / Fund Management
Rabobank	Panel bank
Raiffeisen Schweiz Genossenschaft	Lending bank
Royal Bank of Canada	Panel bank
RBS	Panel bank
Roche	Corporate
Rothschild	Bank
RPC Group	Corporate
Sanofi	Corporate
Santander	Panel bank
Securities Industry and Financial Markets Association	Association
SGS	Corporate
Shell	Corporate
Shinkin Central Bank	Bank
Societe Generale	Panel bank
Societe Generale Gestion	Insurance / Asset / Fund Management

Sompo Japan Nipponkoa Insurance Inc	Insurance / Asset / Fund Management
St.Galler Kantonalbank AG	Lending Bank
Standard Life	Insurance / Asset / Fund Management
State Street Global Advisors	Insurance / Asset / Fund Management
Stern School of Business, New York University	Academic
Sumitomo Mitsui Banking Corporation	Panel Bank
Swiss & Global Asset Management	Insurance / Asset / Fund Management
The Norinchukin Bank	Panel bank
The Investment Association	Association
The Norinchukin Bank	Panel bank
Tokyo Financial Exchange	Exchange
UBS	Panel bank
Union Bancaire Privée	Insurance / Asset / Fund Management
Vodafone	Corporate
Wholesale Market Brokers Association	Association

APPENDIX 2 – LIBOR Evolution FAQs

Q1 What is the definition of LIBOR?

A1 Currently there is no single definition of LIBOR, rather different participants refer to LIBOR based on varying combinations of:

- its name - London Interbank Offered Rate
- the question asked of submitters, which is currently **"***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?"*, and
- market practice for bank unsecured funding activity.

Some contracts refer to LIBOR based simply on its location on a specific data distributor's screen, while others continue to refer to it as BBA LIBOR.

The British Bankers' Association (which, through BBA LIBOR Limited, was the previous administrator of LIBOR) changed the LIBOR question in 1998 from a rate at which the submitter believed a prime bank would be offered deposits in the market to a rate at which the panel bank itself could borrow funds. This was the last occasion when the definition was re-examined and changed.

Q2 Why does LIBOR exist?

A2 LIBOR was initially developed in May 1970 to facilitate syndicated debt transactions. Its development was further driven by the growth in new financial instruments which also required standardised interest rate benchmarks.

LIBOR has global significance. It is referenced by an estimated US$ 350 trillion of outstanding business in maturities ranging from overnight to more than 30 years.

IBA regards the continuity of LIBOR as imperative in order to:

- support the legal efficacy of existing, outstanding contracts, and
- allow for development and continuous operation of efficient risk management tools to manage exposures undertaken within existing contracts.

Q3 What were the FSB's proposals for LIBOR?

A3 On 22 July 2014, the FSB published its proposed reforms for major interest rate benchmarks.1

The main areas of discussion in the FSB report revolve around a multiple-rate approach:

(1) Strengthening the existing 'IBORs and other potential reference rates based on unsecured bank funding costs by underpinning them to the greatest extent possible with transactions data ("IBOR+")

(2) Developing alternative, nearly risk-free reference rates (RFR) since FSB Members believe that certain financial transactions, including many derivatives transactions, are better suited to reference rates that are closer to risk-free.

The FSB Report further stated that one of the overarching objectives of the reforms should be that:

"Reference rates should be based exclusively in actual transactions. However, in many cases insufficient transactions will be available to do this and so the degree of dependence on transactions should vary by currency and will depend on market liquidity, depth and data sufficiency. When conditions in the local market do not allow pure transaction rates (ones derived mechanically from transacted data without use of expert judgement), authorities should work with and guide the private sector to promote rates which are derived on a waterfall of different data types: underlying market transactions first, then transactions in related markets, then committed quotes, and then indicative quotes."

Q4 What is the FSB's timetable for changes to LIBOR?

A4 The timetable proposed by the FSB is that:

- By end Q1 2015:

  IBA will have worked with contributing banks to analyse available transaction data.

- By end Q2 2015:

  In conjunction with the Bank of England and FCA, IBA will have considered the recommended LIBOR methodology and the viability of each LIBOR tenor.

- By end 2015:

  IBA will have publicly consulted on changes.

Q5 What are IBA's findings as the LIBOR administrator?

A5 IBA's key findings to date are:

- the inter-bank unsecured lending market had reduced significantly during the global financial crisis of 2007/2009 and the level of activity remains too low in some tenors to fully support the FSB's proposals and the earlier recommendations in the Wheatley Review[4] that LIBOR submissions should be explicitly and transparently supported by transaction data

- the stress on the unsecured inter-bank markets for term borrowing has been driven by several factors: a significant increase in perceived risk of counterparty default (credit risk); regulatory capital charges, arising from the perceived increase in counterparty risk, which have reduced the demand for unsecured funding; the introduction of liquidity coverage ratios which have modified the demand and supply of inter-bank funding, as banks transition to more longer maturity funding and more secured funding sources; and a significant increase in liquidity available to banks through the exceptional measures taken by major central banks in response to the financial crisis, and

- Benchmark submitters already use a wide range of transactions to anchor their ICE LIBOR submissions within the existing waterfall of methodologies in Box 4.B of the Wheatley Review.

Q6 What are the advantages of basing ICE LIBOR in transactions?

A6 The key advantages are:

- fulfilling the strategic objectives set by the FSB
- minimising the use of qualitative Expert Judgment in favour of verifiable and auditable data
- significantly reducing regulatory risk to submitting banks, making their submissions less susceptible to manipulation and maximising Benchmark submitters' ability to justify evidentially the basis for their submissions, and
- potentially restoring the submitting banks' wish to participate in setting LIBOR and over time attracting new banks wanting to play their part by providing transactional data to IBA for the compilation of ICE LIBOR.

Q7 Is LIBOR still susceptible to manipulation?

A7 The following safeguards have been put in place:

- the introduction by the UK authorities of statutory regulation for the administration of, and submission to, LIBOR, including an Approved Persons regime, to provide the assurance of credible independent supervision, oversight and enforcement, both civil and criminal
- the appointment of IBA as independent administrator and the increased governance that has been put in place in both the submission and administration processes making any manipulation of LIBOR rates harder
- implementation by IBA of bespoke surveillance system, with a dedicated team that assesses the credibility of submissions and seeks to identify breaches of submission standards and tolerances through a combination of alerts and pattern-matching
- governance and control mechanisms established within the panel banks
- the FCA requirement for each panel bank to have an individual who is personally accountable for the bank's LIBOR submission activity, and
- external auditing of administrator and submitters.

Attempted manipulation would now have to involve a significant number of people within one or more banks bypassing control mechanisms.

As a result of these changes LIBOR is now harder to manipulate, it is more likely that any attempt to manipulate will be discovered and there are appropriate legal punishments associated with any attempts at manipulation.

Q8 With IBA's more prescriptive calculation methodology, how will you ensure that the parameters remain relevant?

A8 The LIBOR Oversight Committee will play an important role in keeping under review the pre-defined parameters that will be put in place.

Q9 Does IBA administer any other benchmarks?

A9 IBA is also the administrator of the following benchmarks:

- The LBMA Gold Price, the predominant indicator of the physical spot gold price, accepted worldwide, and

- ICE Swap Rate, globally recognized as the benchmark for annual swap rates for interest rate swap transactions.

Q10 Where can I find out more about ICE LIBOR and IBA?

A10 Please see https://www.theice.com.

Q11 How do I contact IBA if I have further queries?

A11 Please direct any queries to IBA@theice.com, call +44 (0)20 7429 7100 or contact us by post at:

ICE Benchmark Administration Limited
Milton Gate
60 Chiswell St
London
EC1Y 4SA

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