

P.R.I.M.E. Finance
Panel of Recognized International Market Experts in Finance

BENCHMARKS AND BENCHMARK TRANSITION



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INTRODUCTION: LOTS OF HATS

Over the last few years, I have examined the legal risks of benchmark reform wearing three hats:

1. Chief Executive of the FMLC: FMLC paper on Wheatley Review and EU Benchmarks Regulation
2. Markets Participants Group, established by the FSB's OSSG: drawing up suggestions for benchmark transition
3. Chair of LIBOR Oversight Committee: scrutinise the fixing of LIBOR and devise a means to make LIBOR more reliable and transparent



KEY REGULATORY DEVELOPMENTS

1. Wheatley Review 2012 and its implementation
2. IOSCO's Principles for Financial Benchmarks
3. Financial Stability Board's ("FSB's") Official Sector Steering Group ("OSSG")
4. EU's proposed Regulation on benchmarks
5. FSB's Final Report on Foreign Exchange Benchmarks
6. The Fair and Effective Markets Review



BENCHMARK REFORM: WHEATLEY REVIEW, THEN AND NOW

THEN: in 2012, the concern was that even relatively minor references to existing benchmarks, unless carefully managed, posed a legal risk for \$300 trillion worth of outstanding contracts which refer to LIBOR

NOW: the Wheatley reforms have been largely implemented. Currencies and tenors have been withdrawn and the administration of LIBOR has passed from the British Bankers' Association to ICE Benchmark Administration (IBA)



IOSCO Principles for Financial Benchmarks

Superseded the Wheatley Review
Key Recommendations regarding

1. Governance arrangements
2. Quality of benchmarks
3. Quality of methodology
4. Accountability

FSB Official Sector Steering Group

Regulators in the shape of the FSB's OSSG examined the bigger question:

How do we transition to wholly new benchmarks that are compliant with the IOSCO Principles?



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The Evolution of LIBOR

- Statutory regulation of the administration of and submission to LIBOR in the UK
 - (already regulated under certain provisions, dedicated legislation expected from April 2015)
- IBA Position Paper on the Evolution of ICE LIBOR proposes
 - Prescriptive calculation methodology
 - Expansion of contributing banks
 - Anchoring ICE LIBOR further in different types of transactions (e.g. OIS, Repos, FX Forwards, FRAs and FRNs) when there are insufficient direct transactions
 - Consideration of alternatives to the current ‘trimmed arithmetic mean’ calculation



EU's proposed Regulation on benchmarks

- Scope:
 - All published benchmarks used to reference a financial instrument traded or admitted to trading on a regulated venue.
- Notable provisions:
 - Third country benchmarks (articles 19 - 21)
 - Require 'equivalence decision'
 - Critical benchmarks (articles 12 – 14)
 - Majority of contributors = supervised entities
 - Reference financial instruments with a notional value in excess of €500 billion
 - Authorisation and supervision of administrators (articles 5 – 11; 22 - 24)
 - A complete reform of market and business practices



Related Regulatory Developments

FSB Final Report on Foreign Exchange Benchmarks

- Recommendations regarding
 - the calculation methodology of the WMR benchmark rates;
 - the publication of reference rates by central banks;
 - market infrastructure in relation to the execution of fix trades; and
 - the behaviour of market participants around the time of the major FX benchmarks

The Fair and Effective Markets Review

- Joint review by HM Treasury, the Bank of England and the Financial Conduct Authority into the way wholesale financial markets operate.
 - Consultation on Market Manipulation (Chapter 5)
 - 7 New Benchmarks to fall within the Regulatory scope of the Financial Conduct Authority



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FLAWLESS BENCHMARKS?

Objective

To identify a clean benchmark

Problem

Transitioning legacy contracts to wholly new benchmarks raises the spectre of legal risk on a new scale



MITIGATING LEGAL RISK

The FSB noted that benchmark transition would incur legal risk.

How likely is this risk to materialise?



MITIGATING LEGAL RISK (contd.)

In answering this we can draw comfort from market participants' reluctance to litigate. The following provide reassurance:

1. In 1981 the Minimum lending Rate ceased to be published.
2. In 1998, the British Bankers Association took the decision to calculate LIBOR, not as a "prime bank" reference rate but rather as a rate reflecting panel banks' "own cost of funds."
3. On 31 January 2014, the British Bankers Association ceased to act as the administrator for LIBOR and the benchmark was transferred to its current administrator: ICE Benchmark Administration Ltd.



CONCLUSION: THE CHALLENGE THAT WE FACE

There is every reason to be optimistic that benchmark reform will occur seamlessly in the next few years as it has on the occasions discussed above. While this may be disappointing news for lawyers, it is very good news indeed for the markets.

