

MEMO# 26391

August 10, 2012

UK Treasury Publishes Initial Discussion Paper on LIBOR; Requests Comment by September 7

[26391]

August 10, 2012

TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 42-12
INTERNATIONAL COMMITTEE No. 29-12
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 48-12
SEC RULES COMMITTEE No. 50-12 RE: UK TREASURY PUBLISHES INITIAL DISCUSSION PAPER ON LIBOR; REQUESTS COMMENT BY SEPTEMBER 7

As you know, regulators around the world have been investigating a number of institutions for alleged misconduct relating to the London Inter-Bank Offered Rate (LIBOR) and other similar benchmarks.

As part of its response, the UK Government has established an independent review into a number of aspects of the setting and usage of LIBOR. This review is being called The Wheatley Review, named for Martin Wheatley, the managing director of the FSA. The Wheatley Review is tasked with presenting policy recommendations to the UK Chancellor of the Exchequer by the end of September on:

- 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.

The Wheatley Review has published an initial discussion paper setting out the direction of its initial thinking and inviting comment, which is briefly summarized below. [\[1\]](#) The consultation period is extremely short, as comments are due on September 7.

ICI is considering whether to comment. We will have a conference call on Wednesday, August 15 at 1:00 p.m. Eastern time to discuss the paper and get members' initial reactions. In order to participate, please RSVP to Gwen Kelly at gwen.kelly@ici.org or 202/326-5818. Gwen will provide dial-in information to those who RSVP.

Summary of the Discussion Paper

After providing background information on LIBOR, the paper outlines significant weaknesses in three areas of the current LIBOR framework: calculation methodology, governance, and regulatory oversight. It proceeds from a working assumption that retaining the status quo will not be a viable approach, and changes to all three of those aspects of the framework need to be considered carefully.

Section 3 of the paper sets out detailed ideas on how LIBOR could be reformed. Options for reforming the calculation methodology include determining rates from actual transactions (which would require the establishment of a trade reporting mechanism), augmenting the current submission-based approach with the use of transaction data where available, creating a procedure to corroborate submissions, widening the definition of funding to include all wholesale deposits, reducing the number of maturities and currencies, requiring the publication of LIBOR submissions, and increasing the number of participating banks. [\[2\]](#) Options for reforming governance include broadening the membership of the BBA committee that oversees LIBOR, establishing a clear code of conduct relating to policies and procedures concerning LIBOR submissions, and introducing new penalties and sanctions against contributors for misconduct. [\[3\]](#) The remainder of Section 3 focuses on options to improve regulatory oversight, such as by making LIBOR-related activities “regulated activities” under UK law, and the criminal sanctions regime in the UK.

Section 4 of the paper discusses potential alternatives to LIBOR. It outlines criteria that can be used to determine the suitability of a particular interest rate instrument and lists a number of potential candidates for alternatives to LIBOR, including: central bank policy rates; overnight unsecured lending rates; and rates on certificates of deposit or commercial paper, overnight index swaps, treasury bills, and repurchase agreements. It also discusses the challenges of transitioning to an alternative benchmark (sections 4.24 through 4.36), and concludes by discussing the role of a global benchmark.

Section 5 discusses the potential implications of The Wheatley Review on other benchmarks, noting that there are at least 38 interest rate benchmarks like LIBOR (e.g., EURIBOR, TIBOR, SIBOR, etc.). The paper states that The Wheatley Review will consider making a recommendation for an international body such as the Financial Stability Board (FSB) to develop a set of principles and a common global standard for benchmarks.

Discussion Questions Posed

The paper poses the following questions for discussion, contained in Appendix C:

- Do you agree with our analysis of the issues and failings of 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?
- Could the number of maturities and currencies currently covered by the LIBOR benchmark be reduced?
- 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?

- Which types of financial contract, if any, would be particularly affected by the risks of a transition from LIBOR?
- Are there credible alternative benchmarks that could replace LIBOR's role in 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?
- What role should authorities play in developing and promoting alternatives to LIBOR?
- Are there other important markets or benchmarks that could face similar issues to those identified relating to LIBOR?
- Should there be an overarching framework for key international reference rates?

Robert C. Grohowski
Senior Counsel
Securities Regulation - Investment Companies

endnotes

[1] The Wheatley Review of LIBOR: initial discussion paper (Aug. 2012), available at http://hm-treasury.gov.uk/d/condoc_wheatley_review.pdf. See also speech by Martin Wheatley, The Wheatley Review – the future of Libor (Aug. 10, 2012), available at <http://www.fsa.gov.uk/library/communication/speeches/2012/0810-mw.shtml>.

[2] See sections 3.2 through 3.26 of the paper.

[3] See sections 3.27 through 3.37 of the paper.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.