



LEADING TREASURY
PROFESSIONALS

The Association of Corporate Treasurers

Comments in response to
***Second Position Paper on the Evolution of ICE
LIBOR***

ICE Benchmark Administration Limited,
31 July 2015

October 2015

The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. It is established by Royal Charter in the public interest. Further information is provided at the back of these comments and on our website www.treasurers.org.

Contact details and a link to our approach regarding policy submissions can also be found at the back of these comments.

We canvas the opinion of our members through seminars and conferences, our monthly e-newsletter to members and others, *The Treasurer magazine*, topic-specific working groups and our Policy and Technical Committee.



General

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The ACT consider the benchmark of ICE LIBOR to be very important to non-financial companies. Corporates need a stable and reliable interest rate benchmark for not only business and financial contracts but also to forecast, manage and account for many business activities. A suitable alternative to LIBOR is not obvious and there is a huge volume of legacy contracts that do not deal with LIBOR's unavailability well, if at all.

In October 2014 ICE Benchmark Administration Limited (IBA) sought views on their Position Paper on the Evolution of ICE LIBOR that mooted a number of changes to bring LIBOR fixing more into line with the IOSCO benchmark guidelines.

The ACT responded to the consultation and was broadly supportive of the changes but expressed concern about a number of them including:

- The use of rate reporting from funding centres other than London that “could entail using transactions from domestic as well as offshore funding centres for each currency”. We note that material differences in bank funding costs in Europe with those in New York were seen in the financial crisis of 2007/8.
- The algorithmic inclusion of all eligible transactions by contributing banks since the previous submission (on the prior business day) rather than just taking prior-day rates into account in estimating the rate “just prior to 11 am London time” as at present.

The ACT welcomes this Second Position paper which provides more detail to many of the proposed changes.

We agree with the proposed waterfall approach to calculation methodologies. More importantly we agree with the objective of minimising the use of judgement when suitable trade data is available and the IBA's recognition that judgment should not be eliminated. The inclusion of Expert Adjustments and Expert Judgement is an important input into LIBOR. Judgement is needed to remove unrepresentative input trades or to adjust the calculated rate if the submitting bank felt that it did not reflect the market or the bank's funding cost.

In order to focus LIBOR on observable market transactions we recognise the need to expand and define the range of eligible unsecured wholesale transactions. To this extent we agree with expanding the range of counterparty types and transaction types however we believe sourcing rates from offshore funding centres would fundamentally change LIBOR as we know it today. Such a change requires deep consideration of the impact on LIBOR users, especially in respect of legacy contracts.

Counterparty types

Q1 Do you agree in principle with using corporates as counterparty types?

YES. The ACT agrees that the source of bank funding has changed over recent years and in order to increase the number of actual transaction data points on which to base LIBOR submissions it makes sense to include more counterparty types. We agree in principle with using corporates as a counterparty type because it would only be large or prime corporates who would be in a position to provide funding in such a large transaction size to a bank which are deemed to be wholesale funding. IBA need to define what is a wholesale funding transaction, e.g. the aggregation of SME deposits is not wholesale funding.

Q2 Do you think that transactions with corporates as counterparty should be included with no premium or discount to adjust the transacted prices?

YES. No premium or discount is required as any adjustment made would be arbitrary.

Q3 Do you think that the minimum size threshold should be increased for transactions with corporates?

NO. We believe that any minimum size threshold should be applied consistently across all counterparty types.

Funding centres

Q4 Do you agree with IBA's proposal to maintain an Approved List of Funding Locations?

No. We reiterate the points we made in our submission to IBA's first position paper on the evolution of ICE LIBOR, being that we are very concerned at proposals to take rates from a bank's principal funding centre wherever located rather than its principal funding centre off shore from the currency issuing jurisdiction. LIBORs are offshore rates being rates for transactions outside the jurisdiction of the currency issuer (with the possible exception of sterling LIBOR). A move to use a currency's issuer's domestic market to source rates would be a fundamental change to LIBOR. This could potentially shift material value between parties to contracts, especially at times of financial or political crisis. We believe that any such change requires deep consideration of the impact on LIBOR users, especially in respect of legacy contracts in which such a change would certainly not have been considered.

We believe a weighting system and/or the making of adjustments judged appropriate in the circumstances, might enable domestic transactions to be considered. This could preserve the ability to publish the rate in circumstances such as a crisis. However we recognise this would be an added complication, requiring more judgement and still potentially changing the nature of LIBOR in these circumstances.

Q5 Do you agree that no weighting should be applied to adjust the transacted prices from different funding locations?

YES. It would not make sense to apply a weighting based on location of the funding centre (except in circumstances noted in question 4 above). If it needs a weighting then it shouldn't be on the Approved List of Funding Locations.

Transaction timing

Implementation options

Q6 Which of the four implementation options do you think is best? 1/2/3/4/ other

OTHER. In order to meet the Financial Stability Board's (FSB's) objective of anchoring LIBOR in transactions we recognise that further expansion of the trade data is necessary for some tenors / currencies. However we believe that the collection window should be on the same day, not on the previous day. Whilst option 3 has a same-day transaction window it results in LIBOR not being published until much later in the day. This could be operationally problematic for users of LIBOR, such as the calculation and settlement of Forward Rate Agreements (FRAs). Refer comments in questions 7 and 8 below.

References to dates and times should be to London time.

Q7 Would you find any of the implementation options problematic?

YES. Options 1, 2 and 4 all use data from the previous LIBOR submission or previous business day. We believe there is a significant risk of the rate not being representative of the market at the time of publication, not just over weekends and bank holidays but also when events have occurred overnight, which has had a bearing on the market.

Additionally option 4 (rate as at 11am with a 24 hour data collection window from the previous LIBOR submission) would require more reliance on expert judgement because the benchmark submitters would need to determine the market as at a point in time, even though the transaction data collected would be 24 hours or longer (for weekends and bank holidays).

Option 3 (expanded same-day transaction window) would have an operational impact on users of LIBOR as the publication time occurs later in the day. This could have a particular impact on GBP same day payments such as FRAs as mentioned in Q6 above.

Q8 Do you think that LIBOR should be determined by reference to a point in time (e.g. as of 11.00 London time) or by reference to a period of time (e.g. a 24 hour window)?

We believe that LIBOR should be determined by reference to a date and not a specific point in time but with a wider window than currently. Transaction data from when the markets open in the morning should be used up until the agreed cut-off time. This ties in with the proposed move away from the Administrator's 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 11am?" and the move to IBA's proposed definition of LIBOR: "ICE LIBOR is the benchmark calculated by ICE Benchmark Administration (IBA) on London business days, based on the rate at which submitting banks could fund themselves using eligible unsecured wholesale transactions...."

References to date and time should refer to London time.

Q9 If you think that LIBOR should be determined by reference to a point in time, what time would be optimal in your view?

N/A

Q10 If you think LIBOR should be determined by reference to a point in time, would you be in favour of weighting transactions during the preceding data collection period so that transactions closer to publication time are given relatively greater weight?

We don't agree with using transactions from the previous working day.

Q11 If you think that LIBOR should be determined by reference to a period of time, what period would be optimal in your view?

The same business day (London time) – see answer to Q6 above.

Q12 What do you think would be the impact of moving to a period of time for different product types (e.g. derivatives, options, loans)?

No comment.

Q13 Do you think that there would be merit in treating the Overnight tenors differently because of the different value date?

No comment.

Eligible transaction types

Q14 Do you agree with using FRNs / FCDs to supplement the Level 1 transaction types if necessary?

YES. Floating rate products are an intrinsic part of bank funding but by definition the floating rate note is set with reference to LIBOR.

Q15 Are there any other transaction types that you think could be used to supplement the Level 1 transaction types?

We believe that equivalent bank funding products should also be considered and not just unsecured deposits, CPs and CDs. The Administrator should approve in advance a bank's use of "equivalent" products.

Volume weighted average price (VWAP) with no premiums or discounts

Q16 Do you agree with using the counterparty types with no premium or discount to adjust the transacted prices?

NO. We don't agree that transactions at unrepresentative prices that might be carried out by a bank for various reasons should be included without adjustment. As stated in Q37 we concur with IBA's proposal that Expert Adjustments should be applied by changing the inputs or utilising expert judgement.

Minimum transaction sizes

Q17 Where do you see the balance between, on the one hand, a threshold size that mitigates potential manipulation and, on the other hand, a threshold that does not unduly exclude transactions and is representative of the wholesale market?

Based on the high level analysis provided it is difficult to comment on specifics however we believe different minimum transaction sizes could apply for different tenors.

Q18 Which of the thresholds do you think is more appropriate?

10m + 2 trades / 25m + 3 trades



No comment.

Q19 Would you prefer a different minimum size and / or minimum number of transactions?

No comment.

Q20 Do you think that a uniform threshold size should be applied across all currencies or that different thresholds should apply to different currencies / tenors?

We believe that different thresholds can apply to different currencies and tenors because it needs to reflect what is a wholesale transaction for each of these classes (refer Q1 response).

Transactions with non-standard tenors (tenor bucketing)

Q21 Do you agree with tenor bucketing in principle? YES/NO

No comment.

Q22 Do you agree with the proposed tenor bucketing? YES/NO

No comment.

Q23 Do you think that different considerations should apply over month / quarter / year ends (when there is typically higher volatility in some currencies)?

Under Basel III, observable LIBOR rates over month, quarter and year ends are likely to become very different from bank borrowing rates at the beginning of a month. As it is common for contracts and borrowing facilities to reset on those dates, this effect may lead to significant distortions in the market. It may be necessary in due course to introduce some smoothing into the data to correct for this and so this will need to be monitored for empirical evidence over time in order for a satisfactory solution to be developed.

4. LEVEL 2 INPUTS - TRANSACTION-DERIVED

Q24 Do you agree with using transactions from previous day(s)?

YES. Where there is insufficient Level 1 transactional data and Level 2 transaction-derived data is used it makes sense to use transactions from previous days.

Q25 Do you agree with adjusting transactions from previous day(s)?

YES. If something has happened in the market or at the submitting bank since the previous day then Expert Adjustments to previous day(s) data should be allowed.

Q26 Do you agree with the box of days for which historical transactions can have an effect on submissions (assuming that the bank was not able to revert to Level 1 inputs in that time)?

No comment.

Q27 Do you agree with IBA's proposed decomposition formula for interpolation? YES/NO

No comment.



Q28 Would you prefer linear interpolation? YES/NO

No comment.

Q29 Do you agree that interpolation should not be applied to ON or 1W tenors? YES/NO

No comment.

Q30 Do you think that interpolation with more than one tenor gap is acceptable? (e.g. if a bank has transactions for the 1M and 6M tenors, can the 2M and 3M tenors be interpolated?) YES/NO

No comment.

Q31 What are your views, in the absence of anchor points in the relevant currency, on interpolation from transactions in other currencies (e.g. EUR and USD for CHF and JPY) using FX swaps?

No comment.

Q32 Do you agree with the application of linear extrapolation or the decomposition formula?

No comment.

Q33 Do you agree that extrapolation should not be applied to the ON or 1W tenors (because they are shorter, more liquid and more volatile)? YES/NO

No comment.

34 Do you agree that a bank having more than two points on the curve should use interpolation and then parallel shifts? YES/NO

No comment.

Q35 What are your views on whether extrapolation should only be used to inform shorter tenors as they may not reflect the credit element and liquidity of longer one (e.g. a 3M trade can be used to extrapolate a 2M tenor but not 6M)?

No comment.

5. LEVEL 3 INPUTS – EXPERT ADJUSTMENTS AND EXPERT JUDGEMENT

Q36 Do you agree with using Expert Adjustments in the Scenarios?

YES. We believe that judgement is important and should be used as a “fall back” in the scenarios stated above. We don’t want there to be no discretion at all as situations can arise, such as a crisis events, where transaction data does not reflect the real rate at which the submitting banks could fund themselves.

Q37 Do you agree with the ways in which Expert Adjustments could be applied, i.e. by changing the inputs or utilising expert judgement?

YES. We don’t believe that we can ever get away from the fact that judgement needs to be applied. However from a practical perspective, given the short time frame in which submitters have to provide an Expert Adjustment when needed, we think it is unrealistic for the IBA to expect both the bank’s internal and external auditors to have given the specific adjustment “significant focus” in advance of submission.

Q38 Do you agree with the ways in which Expert Judgement should be framed?

YES. It is difficult to see how a coded algorithm for the Expert Judgement Formula will always produce a meaningful rate at which the bank in question is funding itself. Expert Adjustment by adjusting the rate through the application of expert judgement (as proposed for Level 1 and Level 2) should also be allowed.

Specific comments on allowable inputs to a bank's Expert Judgement Formula are:

- The credit standing of the bank should not need to have been published, for example by a credit rating change (a slow reactive event). A credit event that impacts a bank's cost of funding should immediately be reflected in the bank's calculated (Level 3) LIBOR submission.

6. COMPOSITION OF LIBOR CURRENCY PANELS

Q39 What conditions do you think would need to exist to attract banks to become Benchmark Submitters?

IBA have stated that they "expect over time that our work in streamlining and 'derisking' the submission activity (i.e. basing rates on transactions) will both encourage existing panel banks to remain as submitters and lead to new banks wishing to participate in the formulation of LIBOR."

We understand the IBA's objective is to make LIBOR look transparent and to protect the submitting banks from making judgement so as to attract submitters, however it should be recognised that fraud is still possible when based on actual transactions and adequate controls need to be in place.

We don't agree with IBA's proposal to have a two level system of submitters. The credit composition of LIBOR should be consistent and not based on market volume of transactions.

It should also be noted that a greatly expanded panel of banks may introduce less credit worthy banks which might result in a permanent upward shift in the LIBOR rate. We have severe reservations about this.

7. DEFINITION, CALCULATION AND PUBLICATION

Definition of LIBOR

IBA propose the following definition of LIBOR:

"ICE LIBOR is the benchmark calculated by ICE Benchmark Administration (IBA) on London business days, based on the rate at which submitting banks could fund themselves using eligible unsecured wholesale transactions.

The basis of the calculation is defined by IBA and is published at www.theice.com/IBA. IBA, the benchmark administrator of ICE LIBOR, is authorised and regulated by the Financial Conduct Authority."

Q40 Do you think that the need for the Administrator's Question falls away?

YES. Whether a concise description of LIBOR or Administrator's Question, the objective should be to explain to users the composition of the benchmark in order for them to assess the suitability of its use.

Q41 Do you agree in principle with having a concise description of LIBOR for users of the benchmark?

YES. See answer to Q40 above.

Q42 Do you have any comments on IBA's proposed description of LIBOR for users of the benchmark?

YES. The definition does not specify whether LIBOR is a prime bank rate or one based on less credit worthy banks. It is important to users to understand the credit risk inherent in the benchmark in order for them to add or subject credit spreads as deemed appropriate. We recognise that "prime" itself raises definitional issues. But it shows an intention, and that is what users need to be aware of. Others may be able to suggest a better term.

The definition includes reference to IBA. Given that, in principal, the Administrator may change, and in order to reduce risks to contract continuity, it may be better to replace references to IBA with references to "the Administrator".

Calculation of LIBOR

Q43 Do you think that the methodology to calculate LIBOR should be changed? YES/NO

Without ready access to transaction level LIBOR data it is difficult to find evidence to support a judgement call on this specific point. However the original considerations that led to exclusion of outliers still seem attractive.

Q44 What would you see as the implications of changing the calculation methodology?

No comment – refer Q43 above.

Q45 Which of the possible other calculation methodologies do you prefer?

No comment – refer Q43 above.

Q46 Is there an alternative calculation methodology that you would prefer?

No comment – refer Q43 above.

Q47 Do you agree that individual submissions should be published after three months on a non-attributed rather than on an attributed basis?

YES. The delay in publication of individual submissions was introduced as an additional obstacle to anti-competitive behaviour or collusion by banks. Whilst a useful step it does place greater reliance on IBA to police individual banks. We think this is a good balance and don't see a reason to change it.



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The Association of Corporate Treasurers

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Guidelines about our approach to policy and technical matters are available at <http://www.treasurers.org/technical/manifesto>.

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The Association of Corporate Treasurers, established by Royal Charter



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