THIS MONTH

LIBOR, DERIVATIVES AND CMU

Elections in the UK and Greece defied expectations. Left-wing outsider Jeremy Corbyn is now leader of the UK's opposition party and the Syriza party returned to power in a renewed Greek coalition. We look at the evolution of Libor and how this is going to be formed and published in future. The EMIR review deadline arrived mid-month and we comment on the EU regulator's response, and there are some interesting observations on the push to Capital Markets Union.

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{ IN DEPTH }

LIBOR EVOLUTION

In October 2014, ICE Benchmark Administration (IBA) published a position paper setting out proposed changes to ICE Libor. The ACT's response was broadly supportive (see www.treasurers.org/node/10783), noting that the continued publication of Libor rates was very important for non-financial companies. The ACT expressed concern about the use of rate reporting from funding centres other than London and the algorithmic inclusion of all eligible transactions since the previous submission rather than just taking prior-day rates into account.

IBA has now published a second position paper and seeks comment by 16 October 2015. The key aspects of the proposals haven't changed and aim to anchor Libor to the greatest extent possible in transactions.

Counterparty types is one of the proposed changes. Currently, Libor is calculated based on interbank activity. IBA is proposing to expand the range of counterparties to include, among others, corporate as counterparties to a bank's funding transactions. These transacted prices would not be adjusted with a premium or discount to reflect interbank levels.

Other proposed changes to the inputs into Libor include allowing transactions from overseas funding centres, where the funding centre is on an IBA-approved list; amending the period of time from which transactions are included; introducing additional transactions such as floating rate notes; proposing a volume-weighted average price of transactions be included; and introducing a minimum transaction size threshold for each Libor submitter. Where there is insufficient transactional data, IBA proposes historical transactions, interpolation, and extrapolation or parallel shifts are used as inputs. In specified circumstances the IBA has proposed allowing expert adjustments and judgement for a submitter to alter their calculated rate if they felt that it did not reflect the market. Each submitting bank would be required to devise an expert judgement formula and apply it to their expert judgement framework.

In addition to the inputs into Libor changing, the IBA also proposes changing the definition of Libor, the method of calculation and expanding the current panel of bank submitters. Currently, there is no single definition of Libor and it is often referred to in contracts by its acronym LIBOR (London Interbank Offered Rate) based on its location on a specific data distributor's screen, while others continue to refer to it as BBA Libor. Up until 1998, submissions were based on the question: "At what rate do you think interbank term deposits will be offered by one prime bank to another prime bank for a reasonable market size today at 11am?" In 1998 the question was changed from offered to transacted. The acronym was retained, although Libor was no longer an offered rate. IBA proposes having the following description of Libor for users of the benchmark: "ICE Libor is the benchmark calculated by 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..."

Libor is currently calculated using a trimmed arithmetic mean, with the highest and lowest 25% of submissions excluded. The IBA is seeking input on whether the methodology should be amended and presents historical data comparing the current method (25% trimmed mean) with three alternative methods: 12.5% trimmed mean; untrimmed mean; and untrimmed median. Varying degrees of difference appear throughout the period (see page 44 of http://tinyurl.com/nan27yf).

The ACT intends to respond to the proposed Libor reforms. Please send your feedback to Michelle Price in the policy and technical team at mprice@treasurers.org

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ESMA and other EU regulatory bodies are now looking at the financial stability of CCPs as broader clearing

{ INTERNATIONAL }

TRs AND RELOCATION

European Market Infrastructure Regulation (EMIR) responses: the final date for responses to the EU EMIR consultation was 13 August. The ACT responded (see www.treasurers.org/node/310079) to express its concerns over the workload and reconciliation inefficiency of dual trade reporting to trade repositories (TRs), the concentration of liquidity risk in central counterparties (CCPs) and the inconsistent processes among the G20 participants.

The European Securities and Markets Authority (ESMA) response (http://tinyurl.com/omr6mkg) shows a continued belief in the value of dual TR reporting to ensure all transactions captured; a concern to ensure margin where required would be sufficient to manage abnormal price movements; and that it wants to readdress the hedging exemption for non-financial counterparties.

ESMA and other EU regulatory bodies are now looking at the financial stability of CCPs as broader clearing, ie collateralisation comes into force with ESMA issuing its own review on margin periods (see http://tinyurl.com/nu382lz), which is available for comment until 30 September, while EU legislative proposals on resolution of CCPs in distress are expected to be published by the end of 2015.

Meanwhile, the UK Financial Markets Law Committee and the US Committee on Capital Markets Regulation have published a paper on the continuing inability of the US and the EU to harmonise their own rules to avoid the risk of markets polarising as participants move business to the location which best suits each participant's trade, referred to as 'regulatory arbitrage' by the paper's authors. The joint paper can be found at http://tinyurl.com/nrqadbr

NEW ON THE WEB

View the following technical updates and policy submissions at www.treasurers.org/technical

EACT Report: the latest EACT report as at 3 September can be found at www.treasurers.org/node/9894

A reminder of *The Treasurer's Wiki*: www.treasurers.org/wiki

{ TECHNICAL ROUND-UP }

FRAND AND MMFs

Fair, reasonable and non-discriminatory access to regulated benchmarks (FRAND): on 4 August the ACT responded to the Financial Conduct Authority's call for comments (see www.treasurers.org/node/309189) to note our agreement with the principle of non-discriminatory access to benchmark data. We noted that corporates use such benchmarks as Libor as reference rates and not as traders, and the requirement for fees for access to benchmarks should reflect this light use.

Money market funds (MMFs): International Organization of Securities Commissions has published a peer review of MMFs regulation, which gives insight into changing regulation across 31 jurisdictions, of which 24 are members of the Financial Stability Board (see www.iosco.org/library/pubdocs/pdf/IOSCOPD502.pdf).

This shows that:

- The market is dominated by five jurisdictions: China, France, Ireland, Luxembourg and the US.
- While concerns over net asset value (NAV) are shared, nine jurisdictions do not permit constant NAV funds, and have full implemented regulations to govern constant NAV, which, in the EU, is expected to be achieved with a 3% buffer.
- The EU changes are similar to the US, but their implementation lags behind the US.

The September EACT report (see www.treasurers.org/node/9894) provides an update on the EU legislative process.

{ WATCH THIS SPACE }

EU CAPITAL MARKETS UNION

Meanwhile, Bloomberg carries an article (see www.bloomberg.com/news/articles/2015-09-03/eu-s-disjointed-national-laws-may-undermine-capital-markets-push) that sets out some of the practical legal barriers to Lord Hill's push for Capital Markets Union (CMU). As the ACT had noted in its response on CMU (see www.treasurers.org/node/307325), the differing legal processes, some protected by the treaties the EU resists reopening, across the EU act as a barrier to the movement of capital across the economic zone. Lord Hill's office would need to broach treaty renegotiation with the EU member states to enable progress.

Lord Hill, European commissioner for financial stability, financial services and CMU

REX FEATURES (RIGHT)/SHUTTERSTOCK (TOP)