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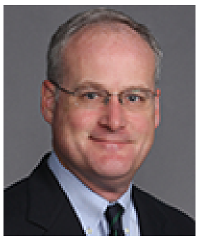
BENCHMARK RATES

Benchmark Rate Reform: Too Far, Too Fast?



BY PAUL FORRESTER, JOHN LAWLOR, AND ROBERT BAPTISTA

In the wake of several widely reported LIBOR and other benchmark rate manipulation scandals, reflected in headline-grabbing stories of official inquiries and investigations and related private litigation,[1] followed in some cases by eye-popping related settlements,[2] policymakers have responded with varied attempts at benchmark rate reforms, which remain a work-in-process as of mid-April 2013.

Notably, on April 16, 2013, the International Organization of Securities Commissions (IOSCO), issued its global Principles for Financial Benchmarks [3], which include standards for governance, regulatory oversight and dealing with conflicts of interest, and which follow an earlier consultative paper[4] in January 2013 that received more than 55 comments[5], including comments from many of the major benchmark rate data services.

Probably the most important pending benchmark rate reform as a practical matter is the implementation of the Final Report[6] of The Wheatley Review[7] of LIBOR and its 10-point plan for comprehensive reform of LIBOR (Wheatley Plan). The Final Report was issued last September and the UK Government accepted the recommendations in the Wheatley Plan in October 2012 (99 BBR 546, 10/2/12).

The value of potentially affected transactions (estimated in the Final Report to be in excess of $300 trillion) affirms the importance of appropriate LIBOR reform as well as the need to implement that reform in a way that does not unduly disrupt affected transactions or the related market. Unfortunately, some early practical experience with the implementation of point #6 of the Wheatley Plan—requiring that the BBA cease compiling and publishing LIBOR for those currencies and tenors for which there is insufficient trade data to corroborate submissions—provides evidence that suggests market participants face a real risk of material disruption.

As contemplated by the Wheatley Plan, the British Bankers Association (BBA), after public consultation, announced[8] on Dec. 14, 2012 a timetable for the discontinuance of compilation and publication of LIBOR for certain currencies and maturities (see Annex 1 to the

[1] See, for example: ''The Worst Banking Scandal Yet?,'' Bloomberg, July 12, 2012 and ''Taking the L-I-E Out of Libor,'' *Bloomberg*, July 9, 2012

[2] Over $2.5 billion so far for Barclays, RBS and UBS with Swiss, UK and U.S. regulators.

[3] Text at http://op.bna.com/bar.nsf/r?Open=jtin-974sqm.

[4] Text at http://op.bna.com/bar.nsf/r?Open=jtin-974syz

[5] Text at http://www.iosco.org/library/index.cfm?section=pubdocs&publicDocID=399

[6] Text at http://cdn.hm-treasury.gov.uk/wheatley_review_libor_finalreport_280912.pdf

[7] At https://www.gov.uk/government/news/the-wheatley-review

[8] At http://www.bbalibor.com/disclaimer/news-releases/bba-reports-findings-of-libor-reform-consultation

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BBA feedback statement), including a complete discontinuance of BBA LIBOR quotations for Australian dollars, Canadian dollars, New Zealand dollars, Danish krone and Swedish krona and the elimination of certain maturities (including two-week and nine-month tenors) for euro, United States dollars, yen, sterling and Swiss francs. Certain of these discontinuances have already occurred, with the remainder scheduled to become effective in May 2013 (deferred from the originally proposed January implementation date to allow users to adapt, and protocols to be developed, to deal with these changes). ISDA has recently published commentary[9] on these discontinuances, which includes a link to a form amendment letter (100 BBR 354, 2/19/13).

In advising our clients regarding these matters, we have found that existing credit and loan agreement documentation often fails to provide clear guidance in some cases. For example, even though the BBA may discontinue its publication of LIBOR for a particular currency or tenor, does that mean that related deposits are ''unavailable'' for a particular lender? If so, does such unavailability trigger fallback to alternative rates? If so, do the alternative rates represent a ''fair'' alternative rate? In some cases, parties may consider invoking the likely present market disruption provision. If so, what is the reputational risk to a lender or group of lenders that does so? These and other similar questions will potentially require attention of senior managers and their counsel.

We are not aware of a consensus approach dealing with these benchmark rate discontinuances. Ultimately, we expect that credit and loan agreement language on definitions of LIBOR and interest period, and the market disruption clause, may change to eliminate some of the issues set forth above. It is possible that certain of the discontinued tenors may no longer be used, at least not as widely as they were before. For the discontinued currencies, other non-BBA benchmark rates will likely be used, such as CDOR for Canadian dollars or BBSW for Australian dollars, and, in fact, the BBA has suggested (but expressly declined to endorse) several possible local alternatives in the BBA feedback statement[10].

With respect to some discontinued tenors, it may be possible to deal with such a situation by interpolating between two other tenors that continue to be quoted, as suggested[11] by ISDA for swaps.

With time, interested parties can be expected to address issues that arise from the discontinuance of certain benchmark rates. This will be made easier by development and market acceptance of replacements or other alternatives. In light of the recently published IOSCO guidance for financial benchmark rates, prudence would suggest that these parties and the market be given time to form a consensus approach.

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[9] Text at http://op.bna.com/bar.nsf/r?Open=jtin-974ujs

[10] Text at http://op.bna.com/bar.nsf/r?Open=jtin-974ut8

[11] At http://op.bna.com/bar.nsf/r?Open=jtin-974uut

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