

# Powers in relation to LIBOR contributions

## **Policy Statement**

PS18/5

March 2018



## This relates to

Consultation Paper 17/15 which is available on our website at [www.fca.org.uk/publications/consultation/cp17-15.pdf](http://www.fca.org.uk/publications/consultation/cp17-15.pdf)

**Please send any comments or queries to:**

Benchmarks Policy  
Markets Policy  
Financial Conduct Authority  
25 The North Colonnade  
London  
E14 5HS

**Telephone:**

020 7066 7018

**Email:**

[cp17-15@fca.org.uk](mailto:cp17-15@fca.org.uk)

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# 1 Overview

## Introduction

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- 1.1** The London Interbank Offered Rate (LIBOR) is a systemically important benchmark, underpinning transactions in many different markets worldwide. It has an aggregate outstanding nominal amount estimated in 2014 as US\$220 trillion.<sup>1</sup> In CP17/15 we consulted on the way in which we would use our powers to compel banks to contribute to LIBOR, under the Financial Services and Markets Act 2000 (FSMA) or under the EU Benchmarks Regulation (BMR)<sup>2</sup>, if we needed to. On 19 December 2017, the European Commission (the Commission) designated LIBOR as a 'critical' benchmark<sup>3</sup> under the BMR, and so it is the BMR powers that would apply.
- 1.2** In this Policy Statement (PS), we feed back on the responses received to our CP17/15. We also report on the data we collected from banks in parallel with the consultation. We explain our conclusions on the methodology we would expect to use if we had to compel one or more banks to contribute input data to LIBOR, using the powers in the BMR.
- 1.3** Since our Consultation Paper (CP) was published, we have announced that the 20 current LIBOR panel banks have agreed to continue to submit to LIBOR until end-2021.<sup>4</sup> We have also said that it is our intention that, at the end of this period, it will no longer be necessary for the FCA to compel submissions because of progress on transition to alternative benchmarks. We hope, therefore, that we no longer face a potential need to compel contributions.
- 1.4** This PS sets out the approach, criteria and methodology that we propose to apply if use of these powers was to become necessary, for example if the agreement with the current panel banks was not in place, or if the agreed period in which to transition to other rates was not available. However, these proposals are based on current circumstances and market conditions. These may change and if there was a future compulsion decision, it would need to be taken in light of the relevant circumstances and market conditions at that time. In view of that, it is important to note that we might need to adapt the approach (including the treatment of different currencies and tenors), selection criteria or the methodology (including the treatment of different entities within the same group) in light of the relevant circumstances or market conditions at the time of any compulsion decision. For example, we may consider whether a new submitter bank could be included quickly enough to warrant use of compulsion powers on that new bank - particularly if we needed to maintain LIBOR for only a short period, for example to allow transition from the relevant LIBOR rates to complete. We would not expect to re-consult on such changes as we would likely need to make decisions urgently. However, we would expect to provide any compelled firm(s) with the reasons for our compulsion decision (including, where possible, details of any material changes to the criteria or methodology).

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1 'Reforming Major Interest Rate Benchmarks', Financial Stability Board, 22 July 2014, [http://www.fsb.org/wp-content/uploads/r\\_140722.pdf](http://www.fsb.org/wp-content/uploads/r_140722.pdf)

2 'Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016' (OJ L171, 29.06.16, p.1) [data.europa.eu/eli/reg/2016/1011/oj](http://data.europa.eu/eli/reg/2016/1011/oj)

3 'Commission Implementing Regulation (EU) 2017/2446 of 19 December 2017' (OJ L346, 28.12.2017, p.1-3). [data.europa.eu/eli/reg\\_impl/2017/2446/oj](http://data.europa.eu/eli/reg_impl/2017/2446/oj)

4 'FCA statement on LIBOR panels' 24 November 2017, [www.fca.org.uk/news/statements/fca-statement-libor-panels](http://www.fca.org.uk/news/statements/fca-statement-libor-panels)



## Who does this affect?

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- 1.5** This consultation most directly affects banks that are current or potential submitters to LIBOR and the administrator of LIBOR, ICE Benchmark Administration Limited (IBA). You may be indirectly affected if you use LIBOR, for example, in hedging products or loan agreements.

## Is this of interest to consumers?

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- 1.6** It will not directly involve retail consumers, but LIBOR is used in many financial products: for example, the interest rate for a loan agreement may be expressed as LIBOR plus X%, or a fixed income investment fund might target a return of LIBOR plus Y%. Retail consumers may, therefore, have an interest in the quality of LIBOR as a benchmark.

## Context

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- 1.7** IBA publishes LIBOR rates daily in 5 currencies (pounds (GBP), US dollars (USD), Euro (EUR), Japanese yen (JPY) and Swiss Franc (CHF)) and 7 tenors, from overnight to 12-month. LIBOR is calculated by IBA on the basis of submissions provided by a panel of banks that submit rates each day. These submissions are currently based on a mixture of transactional and market data and expert judgement by the banks. More information on LIBOR is available in CP17/15 and on the administrator's website<sup>5</sup>.
- 1.8** CP17/15 set out relevant background on LIBOR and the BMR. It noted that the European Securities and Markets Authority (ESMA) had published a methodological framework on 2 June 2017 to promote convergence for the selection of which firms should be required to contribute to critical benchmarks.<sup>6</sup> That framework is guidance and not legally binding. We have followed it, adapting it to reflect the particular nature and circumstances of LIBOR.
- 1.9** On 24 November 2017, we announced<sup>7</sup> that all 20 of the LIBOR panel banks had agreed to remain as submitters until the end of 2021, by which point it is expected that a transition can be made to alternative rates.
- 1.10** We hope that as a result of this agreement, we will not need to use the compulsion powers discussed in this PS.

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5 'ICE LIBOR', [www.theice.com/iba/libor](http://www.theice.com/iba/libor)

6 'Methodological framework: Selection of supervised entities for mandatory contribution under Article 23(7) BMR', ESMA, 2 June 2017, [www.esma.europa.eu/sites/default/files/library/esma70-143-5\\_methodological\\_framework\\_bmr.pdf](http://www.esma.europa.eu/sites/default/files/library/esma70-143-5_methodological_framework_bmr.pdf)

7 'FCA statement on LIBOR panels' 24 November 2017, [www.fca.org.uk/news/statements/fca-statement-libor-panels](http://www.fca.org.uk/news/statements/fca-statement-libor-panels)

## Summary of feedback and our response

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- 1.11** We received 17 responses. 6 of them asked for their responses to be treated as confidential, and the others are listed in Annex 1. Chapter 2 summarises all the responses and gives our views on them.
- 1.12** We do not see any need to update the cost benefit analysis (CBA) or compatibility statement in the CP in the light of the responses.

## Equality and diversity considerations

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- 1.13** Overall, we do not consider that the proposals in this PS adversely impact any of the groups with protected characteristics ie age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment. We received no comments from respondents to CP17/15 on our assessment of equality and diversity considerations.

## Next steps

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- 1.14** You do not need to take action in response to this PS.
- 1.15** As explained above, this PS explains the methodology we would expect to use if we needed to compel one or more banks to contribute to LIBOR. At this stage, we do not expect to need to use it.



## 2 Consultation feedback

- 2.1** This chapter summarises the feedback we received to each of our consultation questions and gives our responses to it.

### Time and costs for a new bank to become a LIBOR contributor

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- 2.2** Around half of the respondents offered estimates of the time it would take for a new contributor to be able to provide input data. These ranged from 10-12 weeks, if contributing transactions only, to 21 months. Most responses were in the range 6 to 12 months.
- 2.3** We also asked about the costs of becoming a contributor. Our CBA had estimated a one-off cost of around £3.5 million, and an annual cost of around £2.4 million. Respondents generally agreed that these were reasonable estimates or offered their own estimates that were not very different. Some said that it would cost more to contribute input data based on expert judgment than if the data were taken from transactions. However, no one gave a quantitative estimate of what difference this might make to the numbers.

#### Our response

This confirms our view that requiring a new bank to contribute input data would involve it in material costs, and that it would take time for a new bank to put in place the systems and controls to allow it to contribute with confidence. We would take this into account in considering any compulsion decision.

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### General approach to use of compulsion powers in relation to LIBOR

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- 2.4** Around half of the respondents expressed support for the general approach. Some specifically agreed that market integrity and consumer protection should be balanced against the cost to banks that we compel. No responses directly opposed the approach or proposed an alternative one.
- 2.5** Some respondents supported the idea of compelling contributions to fewer than all 7 of the existing tenors, on the grounds that the benefits of the less used tenors did not justify the extra costs to the banks. A similar number of respondents opposed that idea. They said that all the rates were important, and that IBA surveys of users had shown strong demand for all tenors.
- 2.6** Some responses said that compulsion should be limited to the currency rates that were most important.

### Our response

We propose to use the general approach as set out in the CP. If we need to compel, we will consider whether to treat the different currencies and tenors differently in light of the circumstances at the time.

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## Description of the market for the participation test

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- 2.7** Most respondents agreed with the proposed description of the appropriate market. A few argued that we should be more international in scope, and not limit it to banks in the UK, and a few suggested that we should extend it further beyond banks to include lending by other financial services firms or even by non-financial firms.

### Our response

In light of the responses, we expect to keep the proposed description of the market. We do not intend to expand the description of the market, as suggested by a few respondents. We think – and other respondents agreed with this – it is important to use the same market that LIBOR intends to measure. However, as noted in the CP, we may need to adjust our description of the market if the LIBOR methodology itself changes over time.

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## Criteria and measures to identify banks

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### Pre-selection criteria

- 2.8** In the CP, we proposed 3 criteria to select the candidate banks:

- presence in the UK
- credit quality
- size measured by group-wide total assets

We used those criteria to identify the 49 banks we collected data from.

- 2.9** A small number of respondents commented on the use of total assets. On the one hand it might mean missing specialist participants in the markets, especially in the currencies with thinner markets overall. On the other hand, it could avoid imposing a disproportionate burden on a smaller bank.



## Our response

We propose to keep size as one of our pre-selection criteria, but we will not use it as a measure of potential participation. This avoids disproportionate burdens on smaller banks, and reflects the fact that LIBOR is based on the rates at which larger banks can borrow.

**2.10** **Measuring actual participation** Every respondent that expressed a view supported our proposal to measure actual participation by using the number and value of unsecured transactions, as defined in the CP. We will use this measure if we need to exercise compulsion powers.

**2.11** **Measuring potential participation** The CP proposed using the following measures of potential participation:

- size of banking group assets
- participation in related markets (listed as interest rate futures, forward rate agreements, interest rate swaps, floating rate notes & Certificates of Deposit, foreign exchange forwards & swaps, and repurchase agreements ('repos')
- lending and borrowing activity (total debt, syndicated loans and business loans)
- presence in the main jurisdiction of a currency

**2.12** A number of existing panel banks argued against using the proposed data on related market transactions. Some said that there would be no benefit in bringing in more banks unless they had transactions in the underlying market. Others said that the instruments listed would be poor indicators of unsecured borrowing rates, mentioning in particular foreign exchange forwards, repos and swaps.

**2.13** There were 3 suggestions for further possible criteria for measuring potential participation:

- historic participation in the underlying market over several years
- exposure of a bank to LIBOR
- perceived expertise and reputation, as in the IBA criteria

## Our response

As noted above, total assets will be used as one of the preselection criteria for being part of the population. In the light of responses, we will not use it as an indicator of potential participation. Other measures of potential participation will take account of the scale of a bank's activities.

We believe that participation in certain related markets is an indicator of the extent to which a bank has expertise and experience in trading in interest rates in relevant currencies. This gives some indication of potential to participate quickly and at scale in the unsecured borrowing



market. We would, therefore, use participation in related markets as one measure of potential participation in unsecured borrowing markets. As noted in Chapter 4, however, we shall not use floating rate transactions, as the data showed very low levels of activity particularly in some currencies.

On lending and borrowing, we believe that the data on total debt are more reliable and consistent and provide enough information, and so we shall use them and not use syndicated loans or business loans.

Despite one comment supporting use of presence in the main jurisdiction of a currency, we have decided not to use this as a criterion. We have good data about the activity of entities and groups in each currency, and we do not think that whether a bank has a physical presence in a jurisdiction will add useful information.

#### **Further criteria**

We are not convinced that any of the proposed further criteria would improve the methodology.

We consider that the 12 months data we have collected for unsecured borrowing are a good measure of actual participation. We do not consider that older data would add useful information about potential future participation.

Exposure to LIBOR does not seem like a good indicator of participation in the underlying market, but could indicate the banks that would have the greatest conflict of interest as contributors to LIBOR.

Expertise and reputation are qualities that will make participation easier for a bank, and are desirable in a contributor. However, they are not easily or reliably quantified. We think that the best quantifiable indicators of them are probably the activity of banks in the unsecured borrowing and related markets.

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### **Draft rule**

**2.14** There were no major issues raised on the draft rule. Besides a few detailed drafting suggestions, comments from respondents included:

- the rule should allow for compelling contributions to fewer than 7 tenors as well as fewer than 5 currencies
- the rule should have an end-date or review date



## Our response

We are not making any Handbook changes as a result of this consultation as we have no need to make a compulsion rule at this stage. Also, now that the Commission has designated LIBOR as critical, we would compel using the power in the BMR (for firms subject to the BMR) rather than by rules under section 137A or 137F of FSMA.

We would decide at the time of any compulsion decision, if ever needed, whether to apply it to individual firms or to a group of firms, as we did with the draft rule.

We shall take the comments on the draft rule into account if we need to use the BMR power. In particular, any BMR compulsion would need to be time-limited, and we would consider whether to apply the decision to fewer than 7 tenors or fewer than 5 currencies.

We consulted separately in CP17/17 on the procedural safeguards we proposed to apply in the event that we exercised a compulsion power. We have published those in near-final rules in PS17/28.

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## EU Benchmarks Regulation

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- 2.15** Our consultation was about how we would use our UK domestic powers in a way that was consistent with the requirements of the BMR. We asked for comments about the use of the powers specifically under the BMR. Now that LIBOR has been designated critical by the Commission, and the BMR applies in full, any compulsion of firms subject to the BMR would now have to be under the BMR (we have similar domestic powers to compel UK branches of third country firms).
- 2.16** Respondents' comments have been taken into account for the specific part of the consultation they related to.

## 3 Data-gathering

### Introduction

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- 3.1** In parallel with the CP, we collected data from banks on which to base our proposals for criteria and measures, and to inform our work on the methodology. We noted in the CP that collecting data would reduce or put an end to urgent requests for data that we would otherwise have to impose on banks if we had to use compulsion powers.
- 3.2** We acknowledged in the CP that consulting and gathering data in parallel ran the risk that we might need a further round of data-gathering if the consultation led us to add new criteria or measures. As noted in Chapter 2, we have concluded that the data we collected were sufficient, and so we do not need to collect more.
- 3.3** The data give us a better picture about the number and pattern of transactions in the unsecured wholesale funding market that LIBOR intends to measure, and in the related markets about which we collected data.
- 3.4** We appreciate the significant effort made by the banks in producing the data.

### Process

- 3.5** We identified 49 banks that met the proposed criteria of being licensed to accept deposits in the UK, having group assets above a defined threshold, and having credit quality similar to the existing panel banks. We wrote to each of these asking for the data set out in the CP.
- 3.6** Our data collection, launched in June 2017, prompted a significant number of requests for clarification. We responded to these and periodically circulated all questions and answers to all the banks as queries were resolved. Only a few banks were able to supply all the data in the initial timescale we set and we extended our deadlines. By November 2017 we had received a complete set of data from all banks, amounting to over 50,000 individual items of data.

### Assessment

- 3.7** We assessed the submitted data, looking at internal consistency and at comparisons between the different submissions and with external data where possible. We went back to the banks for confirmation where we found possible anomalies, gaps or potential errors, leading to some revisions of the initial data.
- 3.8** One caveat is that some banks provided their data on a best efforts basis because of the difficulty of gathering global data across many group entities.
- 3.9** Having scrutinised the data over many months, we believe that the data quality is the best we could reasonably expect to have and that the data are fit for purpose.
- 3.10** The results from the data gathering are consistent with other evidence of low levels of activity in unsecured term wholesale funding markets. Returns from the 49 banks did not suggest that panel composition would provide a way of avoiding the current reliance on expert judgment for many of the currency-tenor rates.



## 4 Methodology

### Introduction

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- 4.1** This chapter sets out how we would use the data if we had to compel firms to contribute to LIBOR. The methodology would produce a ranking of banks for each currency rate. We would use this ranking to select the banks to remain in or join panels, using compulsion if necessary. As noted at 1.4 above, we may need to adapt the methodology if circumstances change.
- 4.2** We shall continue to consider the breadth of participation that is necessary to make sure the rate remains reliable, and the balance between the costs for each bank of contributing and the need for LIBOR for each currency and tenor. The number compelled for each currency panel, and the tenors for which we would compel them would depend on the assessment made in the circumstances at the time.
- 4.3** The CP proposed use of a 'scorecard' method. The methodology has been refined in the light of the CP and the data we collected.
- 4.4** The proposed methodology involves:
- taking all the data elements (identified in Chapter 2) that we have decided to use to assess actual and potential participation in the market LIBOR intends to measure
  - making the different data elements comparable, in particular by normalising them so that values measured in different units or of very different sizes can be combined
  - weighting each normalised data element and then combining the weighted scores for each bank to produce an overall score for each currency rate
  - ranking the banks by the overall scores

### Which data to use

- 4.5** We propose to use the following data:
- Each banking entity's transactions in unsecured wholesale borrowing, using both the number of transactions and the aggregate value – the market that LIBOR intends to measure. This is the measure of actual participation.
  - The entity's transactions in 5 of the 6 proposed related markets: including interest rate futures, forward rate agreements, interest rate swaps, foreign exchange swaps, and repos. As noted at 2.13 above, we will not use transactions in floating rate notes and floating rate certificates of deposit.
  - Group and entity level total debt liabilities, in preference to the data on syndicated and business loans. We judge that total borrowing activity is more relevant to potential participation in unsecured wholesale borrowing than lending activity.

**4.6** We will not use the following proposed measures:

- Floating rate transactions, as explained in 4.5 above.
- Group-level data on transactions. We decided that the entity level data were sufficiently good and more directly relevant, as they will be the information most readily available to a bank.
- Group net assets: as discussed at 2.13 above, this figure was already used to determine the list of 49 banks, all of whom therefore come from large groups. As we are using data on the scale of their activity in interest rate markets and in borrowing, we do not think we need to use this measure of size again in the ranking methodology.
- Whether a group has treasury or interest rate desks geographically located in the home jurisdiction of a currency: again as discussed at 2.13 above, with good data about the transactions in various relevant financial instruments to inform us on actual and potential participation in each currency, we do not think that the location of physical desks is a necessary factor.

#### **Making the data comparable**

**4.7** We will normalise the data by expressing each bank's figure for a data item as a percentage of the total of all banks' data for that data item. We considered alternatives, such as using rankings or deciles, but these did not seem as appropriate for the data we collected. This is because for many items a large proportion of the banks reported values that clustered tightly together, and we did not want to use a method that would treat the banks at the top and bottom of such a cluster very differently.

**4.8** We will cap the percentage each bank can have of any item at 15% so as not to lose the significance of the information from most banks when there are 1 or 2 very high outliers. The excess will be distributed proportionately between the other banks, and if necessary, the exercise is repeated. We considered using more complex methods of flattening the data, but these gave similar results and we decided to use the simpler method.

**4.9** Of the 49 banks with UK licences identified as meeting the size and creditworthiness criteria, 18 turned out to be 9 pairs of banks from the same group. We would expect to treat these banks as separate entities for the weighting and ranking, as it is the level of participation within a contributing entity that will be most important. We would not, however, expect to compel 2 entities from within the same group.

#### **Weightings**

**4.10** Once the data are comparable we shall apply a weighting to each set of normalised and capped data before summing them to give an overall score for each bank for each currency.

- **Number of transactions and value of transactions:** Both are useful forms of information about participation in the market. We will use them with equal 1:1 weighting.
- **Unsecured, wholesale borrowing and related markets:** As indicated in the CP, actual participation in the market LIBOR intends to measure is given a higher weighting than all of the transactions in the related markets taken together. We will use a 2:1 weighting.



- **Short and long term unsecured borrowing:** We collected borrowing numbers at different maturities. In general, there are many more transactions at shorter terms, and we believe that the main problem with lack of transactions is with the longer maturity borrowing. We will therefore weight transactions for 1 month or over more heavily than those for less than 1 month, at 2:1.
- **Entity versus group:** As noted above, the only group level data we propose to use are for total debt liabilities, as many groups centralise borrowing. But we still propose that entity level data should be more important, and weighted more heavily than group data at 2:1.
- **Different related markets:** We propose to weight the 5 related markets we are using (interest rate futures, forward rate agreements, interest rate swaps, foreign exchange swaps, and repos) equally.

# Annex 1

## List of non-confidential respondents

Association of Corporate Treasurers

CME Group

Gdansk Institute for Market Economics

ICE Benchmark Administration Ltd

Japanese Bankers Association

LIBOR Oversight Committee of ICE Benchmark Administration Ltd

Royal Bank of Scotland

Royal Bank of Canada

Société Générale

Dr Thomas Walford

UBS AG



## Annex 2

### Abbreviations used in this paper

<b>BMR</b>	Benchmarks Regulation (Regulation EU 2016/1011)
<b>CBA</b>	Cost benefit analysis
<b>CHF</b>	Swiss Franc
<b>CP</b>	Consultation Paper
<b>ESMA</b>	European Securities and Markets Authority
<b>EU</b>	European Union
<b>EUR</b>	Euro
<b>FSMA</b>	Financial Services and Markets Act 2000
<b>GBP</b>	Pound Sterling
<b>IBA</b>	ICE Benchmark Administration Limited
<b>JPY</b>	Japanese Yen
<b>LIBOR</b>	London Interbank Offered Rate
<b>PS</b>	Policy Statement
<b>USD</b>	US Dollar

We have developed the policy in this Policy Statement in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

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