P.R.I.M.E. Finance

Panel of Recognized International Market Experts in Finance

ISDAFix: An Example of seamless Benchmark transition

By

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Some History

- Since 2009, the FSA, together with other regulators from the US, Canada, Japan, Switzerland and the European Union, started investigating banks for alleged misconduct relating to the IBOR family

- Barclays was the first bank to be indicted for attempted manipulation and false reporting with respect to LIBOR in June 2012

- In Sep 2012, the UK issued the so-called "Wheatley Review of LIBOR" which reached the conclusion that a comprehensive reform of LIBOR was required

- The Wheatley Review made a 10-point plan/recommendations to restore trust in LIBOR

A 10-point plan for comprehensive reform of LIBOR Regulation of LIBOR

1. The authorities should introduce statutory regulation of administration of, and submission to, LIBOR, including an Approved Persons regime, to provide the assurance of credible independent supervision, oversight and enforcement, both civil and criminal,
2. The BBA should transfer responsibility for LIBOR to a new administrator, who will be responsible for compiling and distributing the rate, as well as providing credible internal governance and oversight. This should be achieved through a tender process to be run by an independent committee convened by the regulatory authorities.
3. The new administrator should fulfil specific obligations as part of its governance and oversight of the rate, having due regard to transparency and fair and nondiscriminatory access to the benchmark. These obligations will include surveillance and scrutiny of submissions, publication of a statistical digest of rate submissions, and periodic reviews addressing the issue of whether LIBOR continues to meet market needs effectively and credibly.
4. Submitting banks should immediately look to comply with the submission guidelines presented in this report, making explicit and clear use of transaction data to corroborate their submissions.
5. The new administrator should, as a priority, introduce a code of conduct for submitters that should clearly define: i) guidelines for the explicit use of transaction data to determine submissions; ii) systems and controls for submitting firms; iii) transaction record keeping responsibilities for submitting banks; and iv) a requirement for regular external audit of submitting firms.
6. The BBA and should cease the compilation and publication of LIBOR for those currencies and tenors for which there is insufficient trade data to corroborate submissions, immediately engaging in consultation with users and submitters to plan and implement a phased removal of these rates.
7. The BBA should publish individual LIBOR submissions after 3 months to reduce the potential for submitters to attempt manipulation, and to reduce any potential interpretation of submissions as a signal of creditworthiness.
8. Banks, including those not currently submitting to LIBOR, should be encouraged to participate as widely as possible in the LIBOR compilation process, including, if necessary, through new powers of regulatory compulsion.
9. Market participants using LIBOR should be encouraged to consider and evaluate their use of LIBOR, including the a consideration of whether LIBOR is the most appropriate benchmark for the transactions that they undertake, and whether standard contracts contain adequate contingency provisions covering the event of LIBOR not being produced.
10. The UK authorities should work closely with the European and international community and contribute fully to the debate on the long-term future of LIBOR and other global benchmarks, establishing and promoting clear principles for effective global benchmarks.

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The ISDA Review of ISDAFix

- In view of these developments, in the beginning of 2013 ISDA undertook an independent review of ISDA – conduct by an outside law firm which, in turn hired Oliver Wyman to consult on this review

- In Jul 2013, IOSCO issued their report on Principles of Benchmarks which further informed the review undertaken by ISDA

- The independent review of ISDAFix identified a series of deficiencies. Specifically,
  - ISDAFix Bank submissions were not based on transactional data
  - Bank submission practices varied among currencies (different for USD than other currencies)
  - ISDA did not have the necessary infrastructure in place to conduct the necessary surveillance and scrutiny of submissions, and the associated requirements for publishing a statistical digest of rate submissions
  - ISDA would become subject the regulatory oversight with respect to its activities as the ISDAFix administrator

ISDA’s approach to “fix” ISDAFix

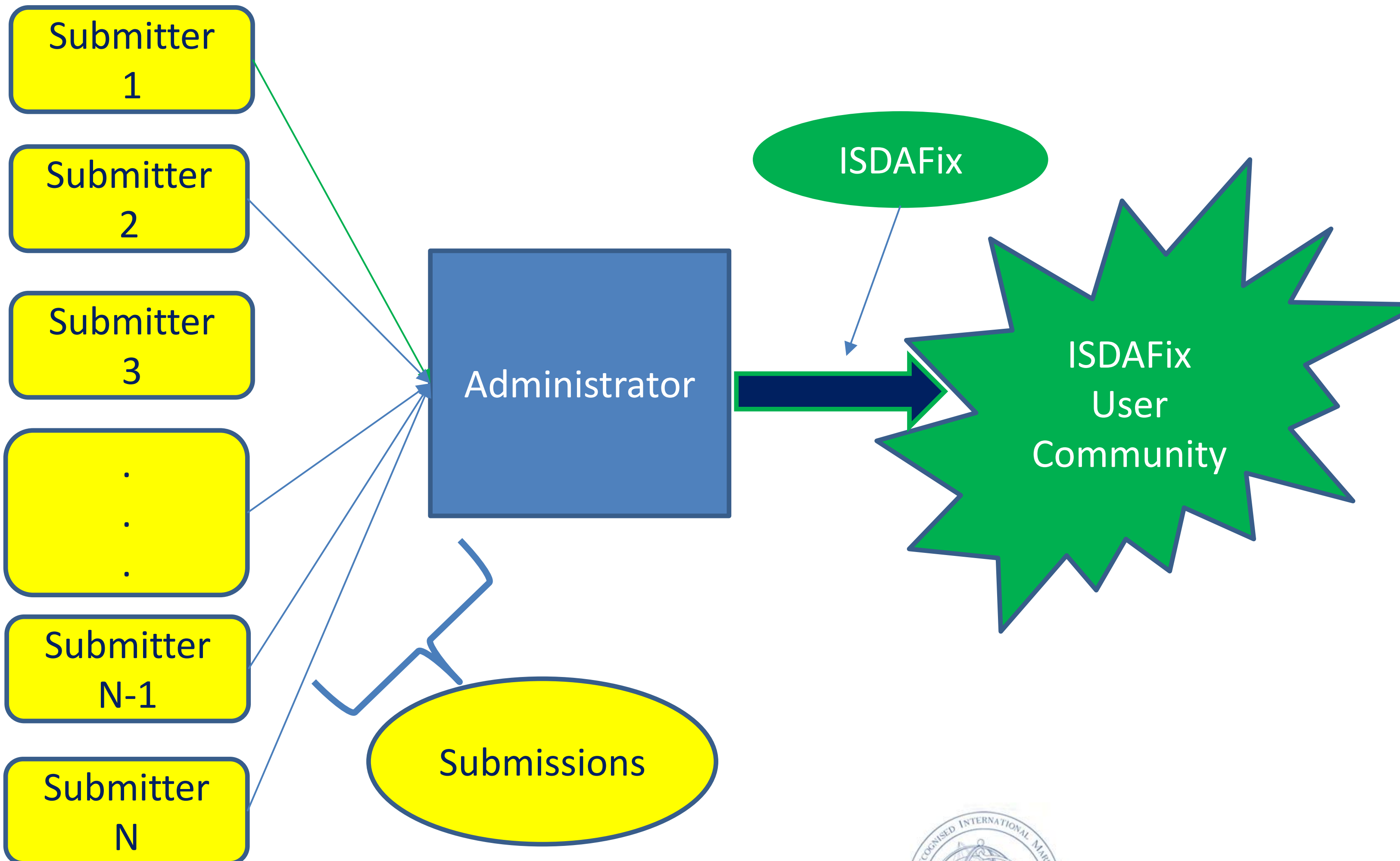
- In addressing the findings of the independent review, ISDA’s Board directed ISDA to address any deficiencies with respect to its activities as the ISDAFix administrator

- In addition, and because the need for regulatory oversight of this activity would be incompatible and perhaps in conflict with ISDA’s other activities, ISDA’s Board directed ISDA to initiate the process of spinning off the reformed ISDAFix administration

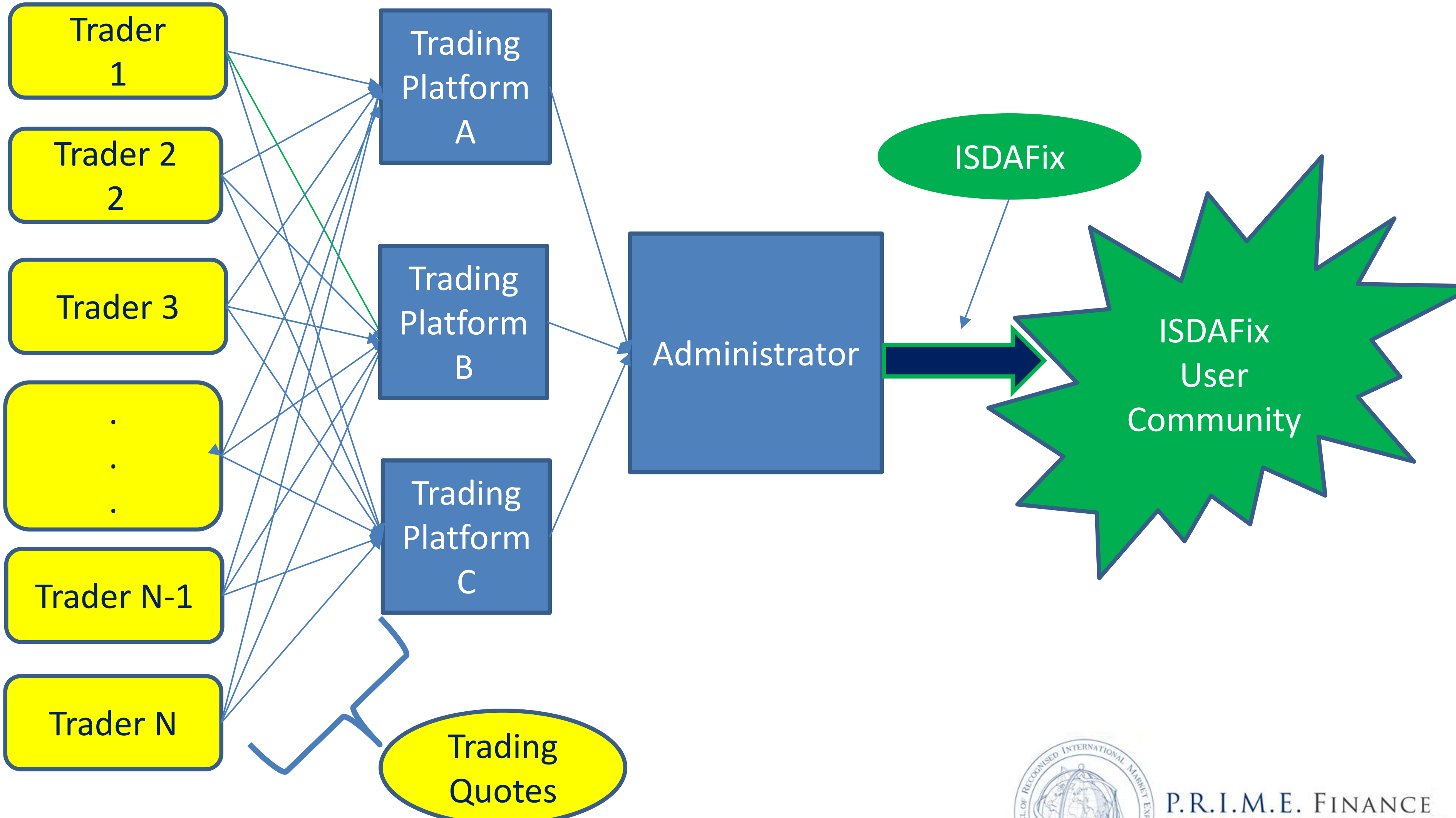
- In addressing the regulatory requirement to use transaction data, ISDA made the decision to undertake a complete revamp of its submission methodology

- Working Oliver Wyman, it developed from scratch a new methodology which was based on firm tradeable quotes derived from regulated electronic trading venues (SEFs, MTFs)

An overview of ISDA's approach - Before



An overview of ISDA's approach - After



ISDA's approach to "fix" ISDAFix

- The following features are noteworthy with respect to ISDA's approach:
  - Relies on tradeable quotes, and is thus consistent with regulatory requirements
  - Eliminates completely subjective or expert judgement
  - Eliminates the need for submissions, and thus the need/fear/risk associated with being a "submitter"

- Following the introduction of the new methodology, ISDA conducted an RFP process to spin off the ISDAFix administration. ICE Benchmark Administration (IBA) – a subsidiary of ICE – emerged as the winner

- IBA has subsequently renamed ISDAFix to ICE Swap Rate

- The ICE Swap Rate was the first global benchmark to transition from a submission-based rate, which used inputs from a panel of banks, to a rate based on tradable quotes sourced from regulated electronic trading venues – requiring no subjective or expert judgment

- ICE Swap Rate is a regulated benchmark under the rules of the Financial Conduct Authority and has been designed to be fully compliant with the IOSCO Principles for Financial Benchmarks

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