FSB FINANCIAL STABILITY BOARD

29 August 2013

Progress report on the oversight and governance framework for financial benchmark reform

Report to G20 Finance Ministers and Central Bank Governors

Introduction

The cases of attempted market manipulation and false reporting of global reference rates, together with the post-crisis decline in liquidity in interbank unsecured deposit markets, have undermined confidence in the reliability and robustness of existing interbank benchmark interest rates. As is well understood, however, without liquidity in unsecured interbank markets, the price discovery process in those markets will remain vulnerable, thus affecting the credibility and reliability of the benchmarks that draw on them. The official sector has an essential role to play in ensuring that widely-used benchmarks are held to appropriate standards of governance, transparency and reliability. The measures proposed by national regulators, international standard setting bodies and central banks - including the Wheatley Review of LIBOR, and reviews by EBA/ESMA, IOSCO, and ECC Governors of reference rates as a whole - to restore the governance and oversight processes of benchmark rates need to be implemented with high priority and urgency[1].

The Financial Stability Board (FSB) has been tasked by the G20 to promote consistency in these assessments and to ensure that national/regional authorities adopt a coordinated approach. Within its broader mandate, the FSB will also promote widespread support, dissemination and adoption of any principles and good practices that emerge regarding the benchmark setting process.

Official Sector Steering Group

To take the work forward, the FSB has established a high-level Official Sector Steering Group (OSSG) of regulators and central banks. The OSSG is responsible for coordinating and maintaining the consistency of reviews of existing interest rate benchmarks and for guiding

[1] G20 Declaration, February 2013 “We also expect more progress on measures to improve the oversight and governance frameworks for financial benchmarks coordinated under the current FSB agenda this year, including the promotion of widespread adoption of principles and good practices and ask for reporting to our Leaders at the St Petersburg Summit.”

the work of a Market Participants Group which will examine the feasibility and viability of adopting additional reference rates and potential transition issues. The Group is co-chaired by Martin Wheatley, CEO of the UK's Financial Conduct Authority, and Jeremy C. Stein, Member, Board of Governors of the Federal Reserve System and comprises senior representatives of central banks and regulatory agencies from the home markets of the most widely used interbank benchmark rates or that oversee the banks that are leading contributors to those benchmarks (Annex 1 lists the membership of the OSSG). The FSB has decided that the OSSG shall focus its initial work on the interest rate benchmarks that are considered to play the most fundamental role in the global financial system.

The FSB asked the OSSG to review the standards and principles for sound benchmarks developed by the relevant standard setting bodies, with a view to recommending to the FSB whether adoption or endorsement of a single consolidated set of principles would be desirable. Following the recommendation of the OSSG, the FSB has endorsed the IOSCO Principles for Financial Benchmarks (IOSCO Principles) published in July 2013 which cover the important issues of benchmark governance, integrity, methodology, quality and accountability.[2]

The OSSG's future work programme includes:

Recommendations for conducting assessments of the governance and processes that relate to existing interest-rate benchmarks using the endorsed IOSCO Principles. Assessing the relevant benchmarks against internationally agreed standards is intended to demonstrate to the market and the general public that the deficiencies in benchmark design and the absence of robust governance processes that contributed to past abuses involving these benchmarks are being effectively addressed. The FSB has accepted the OSSG recommendation that IOSCO be commissioned to conduct an initial review of the most widely used benchmarks against its Principles. The OSSG will report back to the FSB on the outcome of these reviews by June 2014. The assessment process should provide for public dissemination of its findings.

Encouraging the private sector to identify additional benchmark rates. As requested by the FSB, the OSSG is establishing a Market Participants Group (MPG). The MPG is chaired by Darrell Duffie, Professor of Finance at Stanford University. The Vice-Chair is Stephen O'Connor, the Chair of ISDA. The composition of the MPG seeks to achieve a balance among currencies, jurisdictions, types of financial intermediary and the buy-side and sell-side. The terms of reference for the group (see Annex 2) fall into two main areas[3]:

a. Proposing options for robust reference interest rates that could serve as potential alternatives to the most widely-used, existing benchmark rates. The proposed rates should be consistent with the IOSCO Principles.

[2] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf

[3] The full terms of reference and membership of the MPG are attached as Annex 2 and 3.

b. Proposing strategies (testing, protocols, and timing) for any transition to new reference rates and for dealing with legacy contracts in the national or regional currency. This should include identifying problems that could arise in moving to new benchmark rates, and how these can be addressed.

The MPG has been asked to provide an interim report and draft recommendations to the OSSG by end-December 2013 and its final report to the OSSG by mid-March 2014.

The OSSG will assess the feasibility and viability of the reformed and alternative benchmark rates proposed by the MPG, and identify any issues that may arise in transitioning to reformed or new proposed interest rate benchmarks and make recommendations for addressing them. Where appropriate, the OSSG will set out methods for encouraging a transition to the alternative/complementary rates recommended by the MPG.

The OSSG will also undertake any other tasks requested by the FSB to support the strengthening of interest rate benchmarks. The OSSG will report to the FSB Steering Committee and Plenary on its findings. The OSSG will provide its analysis and recommendations to the FSB by June 2014.

Annex 1: Composition of the Official Sector Steering Group

Bank of Canada

Bank of England

Bank of Japan

Bank of Mexico

Central Bank of Brazil

European Banking Authority

European Central Bank

European Securities and Markets Authority

Federal Reserve Bank of New York

Federal Reserve Board

Hong Kong Monetary Authority

International Organization of Securities Commissions

Japan Financial Services Agency

Monetary Authority of Singapore

Reserve Bank of Australia

Swiss National Bank

UK Financial Conduct Authority

US Commodity Futures Trading Commission

Annex 2: Market Participants Group on Reforming Interest Rate Benchmarks

Terms of Reference

Background and Objectives

At their June 2013 Plenary, the members of the Financial Stability Board agreed to establish a high-level Official Sector Steering Group (OSSG) comprised of representatives from regulatory agencies and central banks, which will be responsible for coordinating reviews of existing interest rate benchmarks and for establishing and guiding the work of a Market Participants Group (MPG), which will examine the feasibility and viability of adopting additional reference interest rates. The MPG will issue a report of its findings and recommendations to the OSSG, which will assist the MPG as necessary and will review and discuss the report with the MPG.

Role of Market Participants Group

The MPG is asked to submit a report that:

i. Proposes options for robust reference interest rates that could serve as potential alternatives to existing Libor, Euribor, and Tibor benchmark rates. The proposed rates should be consistent with the IOSCO principles adopted by the OSSG. Proposals would include assessing the feasibility and viability of additional benchmarks that are based upon (i.e., anchored in) an active market having observable bona fide, arms-length transactions, and potential plans for adoption of these additional rates.[4] This work should include:

   - A thorough examination of the methodologies that could be employed in establishing each potential additional benchmark and the incentives and ability to manipulate the proposed rates.
   - Suggested administrative and governance structures for the proposed rates.
   - An analysis of the potential interest among market participants and end-users in adopting the proposed rates.

ii. Proposes strategies (testing, protocols, and timing) for any transition to new reference rates and for dealing with legacy contracts in the national or regional currency. This should include identifying problems that could arise in moving to new benchmark

[4] This does not preclude benchmark administrators from using executable bids or offers as a means to construct benchmarks where anchored in an observable market consisting of bona fide, arms-length transactions. See Principle 7, IOSCO Principles for Financial Benchmarks. http://iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf

rates, and how these can be addressed. Among the issues that this work should address are:

- How reference rates are currently treated in the terms and conditions of the contracts that use them. This should include household or corporate loan and insurance contracts that directly impact the nonfinancial sector in addition to derivatives contracts used by the financial sector.
- Potential testing or parallel-runs to pilot new benchmarks.
- Factors to consider in setting timetables for any transition, including the feasibility of setting a uniform date for banks and other market participants to begin using a new benchmark for new contracts.
- The implications of different transition timetables being adopted across jurisdictions and for different rates, and how they should be addressed.
- Strategies to deal with legacy contracts, including whether the long tail of legacy contracts could be reduced, e.g. by trade compression or replacement.
- Other potential transition issues, including the legal, accounting, and tax issues that would arise over the transition to a new benchmark (e.g. continuity of contracts and contract frustration) and what roles can and should the official sector play in providing legal certainty and facilitating transition.

The MPG should, in consultation with the OSSG, engage in outreach to a wide set of stakeholder groups, including end-users (e.g. institutional investors, government-linked institutions consumer associations, corporate treasurers and, where appropriate, non-professional end-users) of the relevant interest rate benchmarks, institutions involved in the production benchmarks (e.g. benchmark administrators and firms involved as calculation agents), and exchanges that trade instruments referencing these benchmarks. The MPG report to the OSSG should demonstrate how stakeholder groups, whether represented or not on the MPG, have been consulted and how their concerns have been addressed.

The MPG may establish sub-groups to examine issues specific to particular benchmark rates, currencies, or financial instruments/markets, and the MPG may, in consultation with the OSSG, co-opt other market participants to serve on these groups where relevant and necessary.

The MPG is to consult periodically with the OSSG, and is to provide the OSSG with the opportunity to comment on any decisions at an early stage.

Governance

- The chair and membership will be appointed by the OSSG
- Members of the MPG will act in a personal capacity.
- Unless directed otherwise by the OSSG, the MPG's internal deliberations and its communications with the OSSG will be treated as confidential.
- For voting and decision making, the presence of 10 MPG members and the Chair will constitute a quorum. Decisions and recommendations should be reached by consensus if possible or by a 2/3 super majority of those present otherwise.
- The MPG will maintain a schedule of conflicts of interests of its members; where appropriate, members will excuse themselves from discussions where actual or potential conflicts exist.
- The MPG shall meet as necessary, with a first meeting scheduled no later than September 10, 2013.
- The FSB shall publish these terms of reference and the membership of the MPG.

Deadlines

End September, 2013	MPG provides a proposed work plan to OSSG and updates the OSSG on any progress.
End December, 2013	MPG provides initial report and draft recommendations to the OSSG.
Mid March, 2014	MPG provides final report and recommendations to the OSSG.

Annex 3: Composition of the Market Participants Group[5]

(as of 2 October 2013)

Darrell Duffie, Chair	Stanford University
Stephen O'Connor, Vice-Chair	ISDA
Yasunobu Arima	The Bank of Tokyo-Mitsubishi UFJ
Justin Chan	HSBC
Laurent Clamagirand	AXA Group
John Cummins	Royal Bank of Scotland
Thomas Deas	FMC Corporation
Lee Edwards	Nestle
Rolf Enderli	Credit Suisse
Lenny Feder	Standard Chartered Bank
John Feeney	National Australia Bank
Jonathan Hall	Goldman Sachs
Andreas Hauschild	Commerzbank AG
Hanno Hirvinen	Pohjola Bank
Atsushi Komatsu	Mizuho Bank
Andrew Longden	Shell
Edward Ocampo	Morgan Stanley
Sandie O'Connor	JPMorgan Chase & Co.
Knut Pohlen	Swiss Re
Richard Prager	BlackRock
Harry Samuel	RBC
Pier Mario Satta	Unicredit Group
Harald Schlosser	Volkswagen Group
Yasuyuki Takeda	Sumitomo Mitsui Banking Corporation

[5] Members of the MPG act in a personal capacity.