[Securities Regulation Daily Wrap Up, CFTC NEWS AND SPEECHES—Demise of LIBOR benchmark takes center stage at MRAC meeting, (Jul. 13, 2018)]

Securities Regulation Daily Wrap Up

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"LIBOR is a widely utilized benchmark that is no longer derived from a widely traded market. It is an enormous edifice built on an eroding foundation—an unsustainable structure," stated CFTC Chairman J. Christopher Giancarlo in his opening remarks at the agency's Market Risk Advisory Committee (MRAC) meeting held in Washington, D.C. In a similar vein, Commissioner Rostin Behnam, the committee's sponsor, identified the rampant misconduct incited by the benchmark's decline, noting that "LIBOR has been subject to pervasive fraud, abuse, and manipulation. Since June 2012, the CFTC has levied sanctions of more than $3.3 billion for LIBOR-related misconduct."

Commissioner Quintenz weighs in. Commissioner Brian Quintenz, for his part, indicated his support for the ongoing benchmark reform initiatives, the development of alternative risk-free rates (RFRs), as well as the efforts of the Alternative Reference Rate Committee (ARRC) to establish the Secured Overnight Financing Rate (SOFR) as a new benchmark rate for U.S. dollar-based business. He also noted "the development of alternative RFRs that are based on actual transactional data from robust, underlying markets will provide a transparent, viable alternative to LIBOR for market participants."

Tone set. The observations by the CFTC's three commissioners set the tone and direction for the day's comprehensive agenda examining the role of LIBOR on the economy, current initiatives, as well the impact of benchmark reform on the derivatives markets. This MRAC meeting featured a reconstituted committee consisting of 36 members representing a broad spectrum of market participants, stakeholders, academics, and public interest groups, as well as a prominent group of panel presenters.

LIBOR must go…and soon. Chairman Giancarlo pointed to a speech made earlier in the day by U.K. Financial Conduct Authority (FCA) Chairman Andrew Baily where he argued that the pace of transition away from LIBOR is not fast enough. Specifically, Baily noted:

- The underlying weakness of LIBOR cannot be remedied.
- LIBOR's discontinuation of LIBOR is NOT something that MAY happen, but is something that WILL happen; and,
- Market participants MUST prepare accordingly.

The erosion of LIBOR and its role in the economy. The day's first panel explored the role of interest rate benchmarks in the economy, the impetus for LIBOR reform, and the current status of global reform initiatives. Panel member David Bowman, an advisor to the Federal Reserve Board of Governors, observed that, "We need to reduce the stock of contracts that reference U.S. dollar LIBOR if the risks are to be fully addressed."

A deeper dive into current initiatives. The second panel of the day engaged in a deeper dive into current initiatives, including efforts led by the ICE Benchmark Administration Limited (IBA) to improve LIBOR and the development of SOFR derivatives.

Agha Mirza, Managing Director at CME Group, spoke optimistically about the development and introduction of SOFR futures contracts which the CME Group launched on May 7, 2018. Mirza noted these contracts were designed alongside the CME's highly liquid Eurodollar instruments with margin offsets available. Since the May launch, over 60 market participants have been active with the new product and including banks, proprietary trading firms, and other users. Open interest stands at around 1700 contracts representing approximately $5 billion in notional value.

The effect of LIBOR reform on the derivatives markets. The day's third panel focused on LIBOR reform's impact on legacy derivatives contracts, the development of fallback language, and key risk management and governance considerations for market participants. Scott O'Malia, CEO of the International Swap Dealer Association (ISDA) and a former CFTC commissioner, provided a detailed update on the association's undertakings as contained in ISDA's Benchmark's Initiative. As part of its undertakings, ISDA surveyed and spoke to 154 institutions in a over 20 countries and asked them what they were doing to prepare for the LIBOR transition to risk free rates.

O'Malia observed, "We did find that there was a high awareness. The survey showed the respondents had a high level of awareness in transition issues with 80 indicating that they were concerned about their exposure to LIBOR. What we did also find is 15 percent did not have any knowledge of the effort and for 29 percent of the respondents, this was their first touch. So in many respects this was a very important first touch and the survey did do its job."

O'Malia also noted, "I would have to say that we're clearly in the education phase right now and every panel I think has confirmed that but we do have to get to a momentum stage which is when the trading really begins." As noted in ISDA's benchmark report, "To ensure a successful and orderly transition, institutions need to be taking action—and starting now."

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