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CORRESPONDENCE MEMORANDUM

DATE: January 24, 2013
TO: Wisconsin Deferred Compensation Board
FROM: Shelly Schueller, Deferred Compensation Director
SUBJECT: Update on LIBOR Rate Setting Situation

This memo is informational only. No Board action is required.

The London Interbank Offered Rate (LIBOR) is an influential benchmark interest rate used by financial institutions around the world. It is set daily in London by a group of 18 banks that submit the interest rates they would expect to pay on a loan from another bank for ten currencies and 15 different time periods. It is also used as a foundation for other rates, such as adjustable rate mortgages. In mid 2012, a scandal erupted regarding LIBOR rate setting when it was discovered that banks were colluding to falsely report their rates. This was apparently done to make their banks appear more creditworthy and to profit from trades.

Manipulating the LIBOR interest rates is illegal and international banks including Barclays Bank in Britain and Swiss bank UBS have been heavily fined for documented LIBOR manipulation. Additional banks are under investigation and lawsuits have been filed by those who feel they have been harmed by artificial LIBOR rate setting. The British Bankers Association is expected to lose its role in setting LIBOR rates and LIBOR reforms are pending. Regulators would like to replace LIBOR with a benchmark based on more readily observable financial transactions.

In recent developments, 8 California counties sued UBS, Barclays, and 20 other banks, alleging millions of dollars of losses because of LIBOR manipulation in January 2013. According to Bloomberg, "The plaintiffs claim they were cheated out of higher interest payments on investments such as interest-rate swaps and corporate bonds tied to Libor."^[1]

^[1] "California Cities Sue Banks Over Libor Rates, Law Firm Says," retrieved from <http://www.bloomberg.com/news/print/2013-01-09/california-cities-sue-banks-over-libor-rates-law-firm-says-1-.html>. January 22, 2013

Reviewed and approved by Matt Stohr, Administrator, Div. of Retirement Services

Electronically signed on 1/29/13

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Staff continues to closely watch developments related to LIBOR rate setting, as the Wisconsin Deferred Compensation Board uses the LIBOR for the Federal Deposit Insurance Corporation (FDIC) bank option offered by BMO Harris Bank. Wisconsin Deferred Compensation (WDC) participants holding assets in the FDIC account receive a blended rate of interest based on the fixed/floating interest rate allocation selected by the WDC Board. BMO Harris Bank reports that it does not participate in the setting of LIBOR US dollar rates, nor does its parent company (BMO Financial Group). Both firms are monitoring the issue.

The WDC's other investment option providers are also monitoring the LIBOR situation and, at the time of this writing, we received the following updates:

- **BlackRock:** Watching developments related to LIBOR class action lawsuits closely in New York. BlackRock will receive notice of any settlement(s) from these lawsuits. If BlackRock believes a proposed settlement recovery is appropriate and of value, it will file a proof of claim. If a proposed recovery does not seem fair, BlackRock may file its own lawsuit. BlackRock will send out periodic updates on this for the Board and other concerned clients.
- **Calvert:** Continuing to monitor the situation but has no planned action at this time.
- **Capital Group (American Funds):** Continues to monitor the events surrounding regulatory inquiries into LIBOR interest rate setting but is not contemplating legal action at this time. Capital Group noted that "although there is some analysis being circulated publically by other institutions regarding estimated losses, it still remains challenging to quantify the impact of LIBOR manipulation and hence determine any potential economic effect." They will take all factors into consideration when assessing individual securities and, in the end, their decisions will be based on fundamental research into each investment and its risk/return profile.
- **Dimensional:** Continuing to monitor developments over the LIBOR issue, but does not currently have any material concerns over the effects of the past manipulation with respect to the DFA US Micro Cap Portfolio. The DFA Micro Cap Portfolio is an equity strategy and does not invest in fixed income instruments such as LIBOR-linked securities. Furthermore, from Dimensional's understanding, most of the financial institutions that have been fined thus far are large-cap names that are not held in the DFA Micro Cap Portfolio. To the extent smaller financial institutions were or are fined, the DFA Micro Cap Portfolio is extremely diversified with no holding representing more than 50 bps of the DFA Micro Cap Portfolio as of October 31, 2012. As a result, DFA is not currently contemplating taking any action on behalf of shareholders in the DFA Micro Cap Portfolio with respect to the LIBOR manipulation issue.
- **Federated:** Continuing to monitor the LIBOR events carefully and will notify clients and prospects when and if they decide to take any actions.

- **Fidelity:** Fidelity's approach to the LIBOR issue has not changed since October 2012. The firm continues to monitor industry developments and pending litigation, and there have been no developments requiring additional action by Fidelity.
- **Galliard:** Gathering information to assess the possible financial impact on client portfolios. While this situation is coming under increased scrutiny, the extent of violation of antitrust, fraud, and other laws, as well as the availability of damages to injured parties has not been fully determined. To Galliard's knowledge, there is no pending class action lawsuit in which a clear economic benefit is guaranteed to result in damages paid to plaintiffs filing suit as holders of floating rate securities paying an interest rate tied to Libor. Thus, it is difficult to determine at this point whether legal action against the banks brought by holders of floating rate securities tied to LIBOR will be successful or what economic benefit would result from such a lawsuit. The legal developments involving floating rate securities seem most relevant to Galliard and its clients at this juncture. Galliard Capital Management has not filed a lawsuit over this matter. Galliard's intention is to continue monitoring and assessing the situation, as more information regarding unanswered questions comes to light and to continue to act in the best interest of Galliard's clients. Since WDC's exposure to the underlying fixed income securities is through Wells Fargo trustee bank collective funds, as a client of the funds, any legal action would need to be brought by the collective funds themselves.
- **T. Rowe Price:** Continuing to monitor the situation very closely. The firm has formed a task force comprised of investment, legal, and operations personnel to monitor the ongoing developments. The task force will focus on what transpired, which companies are involved, and who may be liable, and what impact the fallout from the investigations could have on T. Rowe Price's clients and their holdings. In addition, T. Rowe Price is monitoring the class actions that have been filed against the various banks in connection with the scandal, and will be assessing what further action may be necessary, including T. Rowe Price's clients' eligibility to participate in such class actions as holders of LIBOR-based instruments.
- **Vanguard:** There are no additional updates on the status of this matter since Vanguard previously updated the WDC on October 19, 2012. Vanguard continues to monitor the developments regarding this issue and remains committed to taking the necessary steps to act in the best interest of fund shareholders.

Staff will update the Board on any additional actions taken by WDC investment providers at future Board meetings.

Staff will be available at the February 19, 2013, meeting to discuss the information in this memo.