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CORRESPONDENCE / MEMORANDUM

DATE: July 19, 2013

TO: Wisconsin Deferred Compensation Board Investment Committee

FROM: David Nispel, Chief Legal Counsel
Shelly Schueller, Deferred Compensation Director

SUBJECT: LIBOR Rate Manipulation Update

This memo is an update for informational purposes only. No action is required.

As previously reported to the Board, Department staff continues to monitor developments related to the manipulation of the London Interbank Offered Rate (LIBOR). LIBOR is an influential benchmark interest rate used by financial institutions around the world. It is set daily in London by a group of banks that submit the interest rates they would expect to pay on a loan from another bank. LIBOR is also used as a foundation for other rates, such as adjustable rate mortgages. In mid-2012, a scandal regarding LIBOR rate setting erupted when it was discovered that banks were colluding to falsely report their rates. This was apparently done to make their bank appear more creditworthy and to profit from trades. Manipulating the LIBOR interest rates is illegal and several international banks 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 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 U.S. dollar rates, nor does its parent company (BMO Financial Group). Both firms are monitoring the issue as well.

Since the June 2013 Board meeting, there has been very little activity related to the LIBOR lawsuits. However, a change in the administration and oversight of the LIBOR was announced. The British Banker's Association (BBA) announced on July 9, 2013, that it had awarded a contract to administer LIBOR to the parent company of the New

Reviewed and approved by Robert J. Marchant, Deputy Secretary

Electronically signed 7/23/13

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York Stock Exchange beginning in 2014. This move is expected to help restore confidence in LIBOR and maintain it as an important global benchmark. However, the move has been viewed with skepticism by some who would prefer a neutral third-party administer the LIBOR. Others continue to lobby to replace the LIBOR entirely with a new reference rate based on actual market transactions.

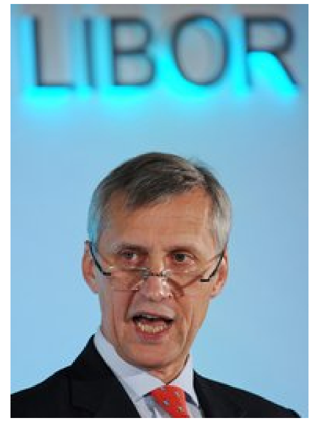
Additionally, two former brokers have been arrested in connection with alleged manipulation of the LIBOR. The men were originally arrested in December 2012 and were officially accused of conspiracy to defraud on July 15, 2013.

Department staff will continue to monitor the situation and update the Board at future meetings. Staff will be available at the August 20, 2013, meeting to discuss this memo.

Attachments: A) "NYSE Euronext to Take Over Libor," Nathaniel Popper. *The New York Times* July 9, 2013.
B) "NYSE Euronext Opens New Front in London With Libor Oversight" Nandini Sukumar. *Bloomberg.* July 10, 2013.

NYSE EuroNext to Take Over Administration of Libor

By NATHANIEL POPPER



Andy Rain/European Pressphoto AgencyMartin Wheatley led a panel that recommended that Libor be formulated independently.

The administration of a distinctly British institution is being handed over to an American company.

The parent company of the New York Stock Exchange won a contract on Tuesday to administer and improve the benchmark interest rate known as Libor, long run by the British Bankers' Association.

The move could help provide a fresh start for Libor, or the London interbank offered rate, which is used to determine the cost of short-term loans around the world. The banks that help set the rate each day have been accused of conspiring to rig the rate for their own benefit before and during the financial crisis, leading to billions of dollars in fines and a few arrests.

The move is a symbolic blow to a British financial industry that has been rocked by scandals and forced to look to the outside for leadership. Last week, a Canadian, Mark Carney, took over leadership of the Bank of England.

The London Stock Exchange was among the four companies that also bid for the Libor contract, said a person briefed on the process, who spoke on the condition of anonymity ahead of a public announcement.

Regulators are taking a broader look at the integrity of the financial data that the global financial system relies on. Libor has already been substantially changed, but some regulators in the United States have said that Libor is too flawed to be fixed and should be replaced.

The job of fixing Libor will not be an easy one. The benchmark is supposed to represent the rate at which banks lend money to each other on an unsecured basis. This is difficult given that banks have generally been unwilling to make unsecured loans to each other since the financial crisis.

Banks have said that their submissions for Libor are an estimate of what the rate would be if they did lend the money. But Gary Gensler, the chairman of the Commodity Futures Trading Commission in the United States, has said publicly that financial institutions should move away from Libor — which he calls a "fiction" — and use benchmarks derived from some sort of transaction.

One of Mr. Gensler's fellow commissioners at the C.F.T.C., Bart Chilton, was critical of the decision to continue allowing Libor to be administered by a company in the financial industry.

NYSE EuroNext to Take Over Administration of Libor
By Nathaniel Popper

"We had a fox guarding the henhouse issue here and we should learn from that," Mr. Chilton said. "I firmly believe that having a truly neutral third-party administrator would be the best alternative, and I'm not sure that an exchange is the proper choice."

Administering Libor is more a matter of prestige than a source of big revenue. NYSE Euronext is paying only a nominal £1 fee for the right to the contract, according to a person briefed on the deal.

A few weeks ago, European regulators approved NYSE Euronext's sale to the IntercontinentalExchange, or ICE, an operator of derivatives exchanges based in Atlanta. NYSE Euronext has been trying to diversify its business beyond its traditional stock exchanges as stock trading volumes and revenue have fallen steadily.

Finbarr Hutcheson, the chief executive of NYSE Liffe, a NYSE Euronext subsidiary in London, said in a statement that his group was interested in "continuing the process of restoring credibility, trust and integrity in Libor as a key global benchmark."

Under the new contract, Libor will keep its name and will remain under the oversight of British regulators. NYSE Euronext is setting up a new subsidiary in London that will run the process. NYSE Euronext is set to take over the administration of Libor early next year.

A new subsidiary, NYSE Euronext Rate Administration Ltd., "will be able to leverage NYSE Euronext's trusted brand, long regulatory experience and market-leading technical ability to return confidence to the administration of Libor," according to a statement from the company.

Until now, the daily process through which Libor is set has been run by the British Bankers' Association, an industry group in London. A British government review of Libor led by Martin Wheatley, at the time the managing director of Britain's Financial Services Authority, recommended last fall that the responsibility for formulating Libor should be given to an "independent party."

The company was picked by an independent committee led by Sarah Hogg, chairwoman of the regulator responsible for financial reporting, after a tender process that started in February. The deal will still need to be approved by the Financial Conduct Authority of Britain, now led by Mr. Wheatley.

The so-called Wheatley Review recommended that Libor continue to be set through daily consultations with the world's largest banks. But while those banks now provide estimates of how much they are charging for short-term loans, in the future the administrators of Libor are also supposed to use data from actual short-term loans.

Julia Werdigier contributed reporting from London.

A version of this article appeared in print on 07/10/2013, on page B3 of the NewYork edition with the headline: NYSE Euronext to Take Over Administration of Libor.

Bloomberg

NYSE Euronext Opens New Front in London With Libor Oversight

By Nandini Sukumar - Jul 10, 2013

NYSE Euronext, whose Liffe exchange is the biggest market for short-term interest rate derivatives, is vowing to restore confidence in the London benchmark at the heart of the financial world's biggest scandal.

The New York Stock Exchange operator said yesterday it will replace the British Bankers' Association in administering the London interbank offered rate following a rigging investigation that has generated $2.5 billion in fines. More than $300 trillion in securities are tied to Libor, which has been regulated by the U.K. Financial Conduct Authority since April as part of an overhaul.

The transfer in 2014, criticized by a member of the U.S. Commodity Futures Trading Commission, is a further enhancement for Liffe, which dominates the market for short-term interest rate derivatives. Ownership of that business means it's in NYSE Euronext (NYX)'s interest that investors have confidence in Libor, said Finbarr Hutcheson, chief executive officer of Liffe.

"Our primary focus is restoring the credibility and integrity of Libor, which we think will be an important benchmark for years to come," Hutcheson said in an interview yesterday. "We'll run it as a commercial business, but our role in restoring the market's trust in Libor is our biggest concern."

Sterling, Euribor

Liffe, Europe's second-largest derivatives exchange, offers Libor-based short sterling futures and Euribor. U.K. regulators recommended the BBA be stripped of responsibility for Libor after finding banks had tried to manipulate it to profit from bets on derivatives.

The rate is at present calculated by a poll carried out daily by Thomson Reuters Corp. for the BBA that asks firms to estimate how much it would cost to borrow from each other for different periods and in different currencies. The top and bottom quartiles of quotes are excluded, and those left are averaged and published for individual currencies in London.

NYSE Euronext will establish a unit for the business, NYSE Euronext Rate Administration Ltd. Decisions on who will calculate the rate, what banks will submit to it and how the process will work have yet to be completed, according to Liffe's Hutcheson. The unit will be run autonomously with separate staff that review the process of rate-setting.

Bloomberg

Liffe History

Liffe was set up in 1982 after the U.K. removed foreign exchange controls starting with futures on interest rates. About a decade later it merged with the London Traded Options Market and in 1996 entered commodities after purchasing the London Commodity Exchange.

The exchange was open outcry until it started electronic trading in November 1998 and in 2000 went fully electronic. It's still based in its offices in the City, as London's financial district is called, overlooking the River Thames, where the trading floor and pit were housed.

In 2002, Euronext NV bought Liffe, fighting off rivals the London Stock Exchange and Deutsche Boerse AG, which owns Eurex, Europe's second-largest derivatives exchange. Euronext, formed from the merger of the Paris, Lisbon, Brussels and Amsterdam stock exchanges, was itself bought by NYSE in 2007.

As the administrator, NYSE (NYX) will be responsible for corroborating banks' submissions to the rate, ensuring they are based as closely as possible on actual trade data, and monitoring suspicious conduct, according to rules introduced by the FCA earlier this year.

Oversight Transfer

Thomson Reuters will have no role in the rate-setting process once responsibility has transferred to NYSE, said Thomson Reuters spokeswoman Yvonne Diaz.

In its probe of Royal Bank of Scotland Group Plc, the FCA said the firm made at least 219 documented requests for inaccurate submissions to Libor. Derivatives traders sat next to Libor submitters "and encouraged the two groups to communicate without restriction despite the obvious risk that the derivatives traders would seek to influence" submissions, the regulator said. RBS was fined $612 million.

Barclays admitted to attempting to rig rates to benefit its own derivatives trades and to appear healthier during the financial crisis by hiding its true cost of borrowing. Authorities including the CFTC and the U.S. Department of Justice are also conducting civil probes, while the DOJ and U.K. Serious Fraud Office are pursuing criminal investigations.

'Return Credibility'

"NYSE Euronext Rate Administration plans to return credibility, trust and integrity to Libor, bringing an essential combination of strong regulatory framework and market-leading validation techniques," Liffe's Hutcheson said.

ICE (ICE), the energy and commodity futures bourse in Atlanta, agreed on Dec. 20 to acquire NYSE Euronext for cash and stock, seeking to expand into interest-rate futures. That market in the U.S. is dominated by CME Group Inc., the world's largest derivatives exchange. CME offers the Libor-based Eurodollar contract while NYSE Liffe US offers a rival Eurodollar contract.

"I don't see any change for us from this," Terry Duffy, chairman of CME, said yesterday in London. "I don't ever see it being a proprietary index. If you were going to make it a proprietary index, you wouldn't sell it for a buck."

NYSE Euronext exchanged 1 pound to take over the business, according to James Dunseath, a NYSE Euronext spokesman.

Gensler Skepticism

Skepticism toward Libor has been expressed by other CFTC members. Gary Gensler, the regulator's chairman, has said benchmarks such as it and Euribor that are based on banks' estimates are "unsustainable" and should be replaced with alternatives based on real data.

Changing the administrator won't address Libor's underlying problems, such as its use of estimates and an increasing propensity of banks to leave their submissions unchanged, according to Rosa Abrantes-Metz, an economist with New York-based consulting firm Global Economics Group Inc. and a professor at New York University's Stern School of Business.

"The fundamental problems are still there," she said.

Bids to run the Libor benchmark were assessed on criteria such as "technical capability, governance and oversight," Martin Wheatley, chief executive officer of the FCA, told reporters in London yesterday. NYSE Euronext "came out as the clear favorites to restore confidence in the system," he said.

New Administrator

The U.K. government formally started the search for a replacement body to set Libor in February after the BBA voted to relinquish operation of the benchmark. A seven-member panel including Sarah Hogg, outgoing chairman of the Financial Reporting Council,Wheatley, and the Bank of England's Paul Fisher recommended the new administrator.

"This change will play a vital role in restoring the international credibility of Libor," Hogg said. NYSE Euronext Rate Administration Ltd. will be a U.K.-based company, and will be regulated in the U.K. by the FCA.

Under rules introduced by the FCA, the administrators of the rate and banks that participate will have to appoint a person approved by the regulator to oversee compliance. The BBA has also stopped quoting Libor for two currencies and eight maturities in a bid to make the benchmark less vulnerable to manipulation.

Bloomberg LP, the parent of Bloomberg News, has proposed an alternative to Libor dubbed the Bloomberg Interbank Offered Rate, or Blibor. It would use data from a variety of financial transactions to reflect participating banks' cost of credit.

Bloomberg

‘Big Bang’

Libor was first published by the BBA in 1986, the year the British Prime Minister’s “Big Bang” program of deregulation fueled a boom in London’s bond and syndicated-loan markets. Originally intended to be a simple benchmark that borrowers and lenders could use to price loans, the rate grew in importance as it was adopted as the basis for setting interest rates from mortgages and student loans to derivatives.

The BBA, whose members are among the world’s largest banks including those who contribute to Libor, was criticized by policy makers in the U.K. and the U.S. for failing to address concerns about the rate-setting process first raised by then New York Fed President Timothy F. Geithner in 2008.

“Restoring confidence in Libor has been an absolute priority for the BBA,” Anthony Browne, CEO of the lobby group, said in a statement yesterday. “We have been working hard with regulatory authorities and the government to put in place much-needed reforms to the system.”

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