ICE Chills Out Over LIBOR Fees

by Steve Brown

Back in July, we wrote about changes regarding the London Interbank Offered Rate (LIBOR) that had the potential to radically affect the use of this standard benchmark in global financial institutions both large and small. Over the decades, LIBOR has become the global floating interest rate commonly used in banks, credit unions and hedge funds as a benchmark for funding and lending of all types. You probably recall that there was some nasty manipulation of LIBOR rates by some of the world's biggest banks for their own profit (imagine that!) during the financial crisis, for which in the end they paid some monstrous fines. As a result of these accountability problems and the need to clean up the index that supports nearly all loans and funding at financial institutions, the administration of the calculation of the rate had to be changed. The administration of LIBOR had previously been carried out by the British Bankers Association, but after the all the legal settlements it was moved to a new organization, the Intercontinental Exchange (ICE).

ICE took over administration in Feb of this year, updating and automating the calculation and including audit capabilities over a process which had previously been compiled by simply polling the major firms that used LIBOR. In addition to developing the new calculation, on Jul 1 ICE introduced new licensing agreements for the use of the index. These were surprisingly broad-based in scope and levied eye-opening annual fees for institutions using LIBOR in any part of their business. It seems that ICE did not realize LIBOR was being used by banks of all sizes to price not only large commercial instruments, but also for student loans, consumer mortgages and numerous other lending and funding functions.

In July the license fee was set at $16K, a reasonable level for global financial behemoths but cost prohibitive for smaller banks. Recall that previously the use of LIBOR was free, unless an institution wanted to redistribute the rates. ICE justified this new fee as necessary in order to develop and implement better measures for not only LIBOR, but other benchmarks which have operated with surprisingly archaic calculations (like the London Gold Fix which has been calculated by hand since 1919).

While everyone agrees that a more transparent, verifiable calculation for LIBOR is necessary for the financial markets to operate properly, clearly a fee of this magnitude is unrealistic for community banks. By itself, the idea of a licensing fee to use a benchmark rate whose usage has become an industry standard even seems contrary to normal business practice. After all, it is estimated that some $300T of securities, loans and derivatives are tied to LIBOR.

In Jul, only a few banks actually received a bill from ICE, but once that happened the banking associations went to work on behalf of community banks. In the meantime, many smaller banks considered whether they would have to move away from the use of LIBOR altogether, although its use is so imbedded in every aspect of the industry that a fundamental change of that magnitude would be extremely difficult to accomplish. Consider how many mortgage and loan documents stipulate the use of LIBOR as a benchmark.

In Aug, ICE CEO Jeff Sprecher indicated that they would be gathering input and fine tuning their approach to fees and in the end they have. Last week, while ICE didn't specifically comment, Bloomberg reported that a tiered licensing schedule will be implemented with institutions that use a single currency. Institutions with less than $1.5B in assets will able to use LIBOR for free, while those above $1.5B but under $10B will pay $2K per year and those above $10B will pay $16K. Institutions using multiple currencies could be subject to fees as high as $40K per year. The annual fee covers references to LIBOR in loan documents and the use of the LIBOR in setting lending rates. For community banks this is good news as it means the index can still be actively used with little or no additional annual cost.

ICE still has plenty of work to do in updating antiquated pricing practices for global indices that perhaps at one time served the purposes of financial markets. Given the size and scope of today's financial markets, many of these methods are no longer robust enough. We support the efforts of ICE and appreciate them warming up to address the needs of community banks.

BANK NEWS

M&A

Royal Savings Bank ($126mm, IL) will acquire PNA Bank ($102mm, IL) for $1.2mm in cash. PNA's parent company previously had filed bankruptcy and Royal was a stalking-horse bidder at an auction.

Branches

CNBC reports SNL Financial analysis finds banks have closed 2,599 branches this year vs. 1,137 opened for a net decline of 1,462. That level is just below the yearly total of 1,487 of 2013. Total US branches now sit at 94,752 and are down about 1.5% from the end of 2013. This is the lowest overall level in 8Ys.

Job Cuts

Research firm Coalition reports global investment banks have reduced head count 10% in fixed-income trading units, as they adjust to significant regulatory changes post-crisis and difficult ongoing market conditions.

No More

Royal Bank of Scotland announced it will exit the US mortgage trading business entirely, as it repositions its business in response to post-crisis regulatory changes.

Interest Rates

Fed NY president Dudley said he thinks it is premature to raise interest rates right now but anticipates rates will begin to rise sometime in 2015. Meanwhile, Fed MN president Kocherlakota said raising rates in 2015 would be a mistake because the 2% inflation goal is not likely to be reached until 2018.