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MARKETS

This Man Wants to Mend, Not End, Libor

ICE Benchmark Administration president suggests pairing a revamped version of Libor with SOFR, the leading candidate to replace it

Timothy Bowler, president of ICE Benchmark Administration, says some form of Libor is needed alongside SOFR, the new borrowing benchmark set to replace Libor. PHOTO: VANESSA BERBERIAN FOR THE WALL STREET JOURNAL

By Daniel Kruger

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Financial regulators around the world agree the London interbank offered rate, a widely used lending benchmark that is prone to manipulation, has to go. But they have struggled to come up with a convenient replacement.

Timothy Bowler, president of ICE Benchmark Administration at Intercontinental Exchange Inc., ICE 1.15% ▲ has an idea to help: Don't ditch Libor altogether; improve it. This year, the exchange rolled out a revamped version, dubbed the U.S. Dollar ICE Bank Yield Index, that Mr. Bowler and its fans say is now more accurate and harder to exploit.

Libor is a crucial part of global financial plumbing. It is an interest rate that underpins $350 trillion of financial contracts world-wide, including U.S. consumer debt such as auto and student loans, and is based on banks' estimates of their short-term borrowing costs.

For years, the rate was seen as a useful yardstick for gauging market risk. Until, that is, banks were found gaming the measure to bolster their own profits. Banks were fined billions of dollars and several traders went to prison as a result.

Now, regulators are on the hunt for a more reliable tool. Coming up with a workable replacement is vital, given Libor's central role in financial markets.

Currently, the front-runner to replace Libor when it retires after 2021 is a gauge called the secured overnight financing rate, or SOFR. Unlike Libor, SOFR measures the cost of borrowing money when the borrower pledges U.S. Treasurys as security—making its rates less vulnerable to meddling, proponents say.

But Mr. Bowler, a former Goldman Sachs Group Inc. banker who has also worked at the U.S. Treasury Department, says some form of Libor is needed alongside SOFR. His argument: The market needs separate benchmarks: one for credit risk, such as his bank yield index, and another for interest-rate risk, such as SOFR.

Transitioning from Libor "is like having to figure out how to re-lay the tracks of the global financial system," and therefore it is the perfect time to roll out a revamped version of Libor and SOFR together, said Mr. Bowler in an interview. The new Libor rate is less easily manipulated because it is based not on estimates, but on specific market trading that set bank bond yields, he said.

For Mr. Bowler and ICE, this is more than just an academic exercise. If he can get regulatory approval for the bank yield index, ICE stands to gain. The exchange acquired Libor from the British Bankers' Association for £1 ($1.30) in 2013; since then, the index has been part of an ICE unit that made $26 million in profit on revenue of $59 million in 2017, the most recent available data.

So far, the Fed has made it clear it views market acceptance of SOFR as a priority. Fed officials declined to comment on possible use of the bank yield index.

Mr. Bowler says his interest in having a Libor-like benchmark is rooted in his experience during the financial crisis.

While a banker at Goldman, he managed the firm's account with Ford Motor Co. At the time, Ford was trying to survive by drawing on its credit lines as rivals General Motors Co. and Chrysler Corp. sought government bailouts.

Had SOFR been the prevailing benchmark then, Mr. Bowler argues, it would have given Ford access to cash at a nearly risk-free rate while Goldman would have had to raise the funds from other banks at much higher rates that reflected the credit crisis. That mismatch would make banks reluctant to lend during a period of stress, he said.

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Like Mr. Bowler, economists from the Bank for International Settlements, which acts as a central bank for central banks, also see a need for multiple benchmarks. A March BIS report says it is possible a variety of rates could “coexist, fulfilling a variety of purposes and market needs.”

Some investors remain skeptical.

“There are huge economies of scale in terms of crowding into one benchmark,” said Edward Al-Hussainy, a debt and currencies analyst at Columbia Threadneedle Investments. The biggest benefit is having to write contracts to a single standard, which should limit the cost of “lawyer hours,” he said.

While some borrowers or lenders may prefer the bank yield index, the underlying trading is going to be “too thin” to maintain its viability, Mr. Al-Hussainy said.

Mr. Bowler concedes the bank yield index isn’t a panacea. For instance, he acknowledges that interest-rate swaps and other derivatives, which account for more than 90% of the $200 trillion in financial contracts in the U.S. tied to Libor, are better served by SOFR.

The bank yield index, by contrast, would be a benchmark for financial institutions’ credit risk, equal to about 5% of the current U.S. Libor market.

Yet ICE has a history of dusting off faulty benchmarks and making them profitable. It acquired the right to manage the fixings of gold prices in 2015 and silver prices in 2017 after they came under regulatory scrutiny.

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