FINANCIAL TIMES

COMPANIES & MARKETS

Wednesday March 28 2012

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Source: Thomson Reuters Datastream

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Sponsors eye tighter controls over Libor

Committee to examine changes to crucial rate

Probes continue into claims of manipulation

By Brooke Masters

The sponsors of the London interbank lending rates used in $350tn of contracts worldwide are considering tighter codes of conduct and new statistical controls at a time when regulators on three continents are probing allegations that the rates may have been manipulated.

Three weeks after promising a review, the British Bankers' Association has convened a steering committee of five global banks, a wholesale broker group and the CME, the futures exchange group, to come up with revisions to the London interbank offered rates that help set the price of financial products, including mortgages and credit cards.

The group will talk to the UK Financial Services Authority, the Bank of England and the Treasury and seek input from other users and contributors, the BBA said. Participants said they hoped to put out a formal reform package by midsummer.

The changes are designed to "provide ongoing confidence to the rate", Angela Knight, chief executive of the BBA, told the Financial Times. "Sensible evolution needs to take place."

Libor rates are set daily in 10 currencies under the auspices of the BBA. Panels of banks submit estimates of their unsecured borrowing costs over 15 time periods to Thomson Reuters, which drops the highest and lowest rates and averages the rest to compute the daily rate.

But the rate-setting process has come under fire in the past couple of years. Users have complained that the short-term rates diverged from other market indices. European Union, US and UK regulators have opened probes into whether the rate-setting banks were tinkering with their bids, either to make themselves look stronger in the financial crisis or to enable traders to make money on interest rate-related derivatives. No charges have been filed.

The reform committee, which includes representatives of Barclays, Lloyds Banking Group, Credit Suisse, Royal Bank of Scotland and HSBC, will look at three areas and receive technical help from the Oliver Wyman consultancy, the BBA said.

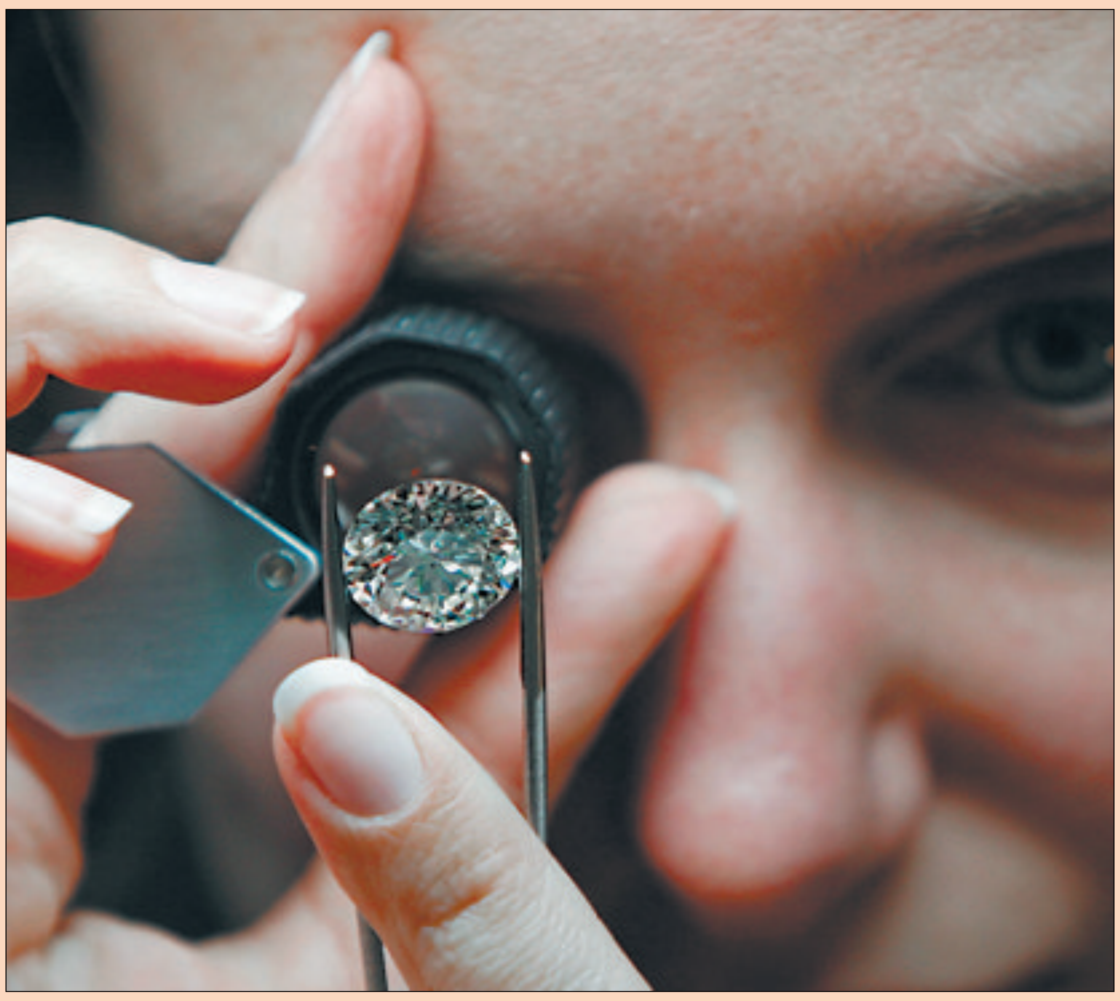
> The aim is to 'provide confidence to the rate. Sensible evolution needs to take place'
>
> **Angela Knight**
> **British Bankers' Association**

The discussions will focus on new rules about who within a bank should be consulted and informed about the daily rate submissions and exactly what financial instruments banks should use as reference points. The committee will also consider whether specific statistical safeguards can insure that an individual bank's submissions remain consistent over time.

Thomson Reuters already investigates bids considered to be outliers but the review will consider whether additional safeguards are needed.

"The market requires a choice of interest rate reference curves and Libor is a vital and important part of this. We are glad to be part of this project," said David Clark, chairman of the Wholesale Markets Brokers' Association.

www.ft.com/libor



Sparkle fades: the group is looking at options, including a trade sale, for its mines

Reuters

Rio business review suggests diamonds are not for ever

By Helen Thomas in New York and Neil Hume in Sydney

Rio Tinto has followed rival BHP Billiton by putting its diamond business on the block, as the biggest mining groups try to prune their portfolios to focus on their highest quality assets.

The mining group yesterday said it was reviewing the future of its three diamond mines in Australia, Canada and Zimbabwe as well as a development project in India. The review will look at several options, including a trade sale and a flotation.

Despite a favourable outlook for the stones, BHP in November also said it was reviewing the future of its Ekati diamond mine in Canada.

Diamond prices faltered in the second half of last year as the European crisis rattled markets, according to Bloomberg, after a period of surging prices. But prices of polished stones still rose 18 per cent last year. With a dearth of new discoveries of large diamond deposits and rising demand from markets such as China, the fundamental outlook for diamonds remains robust, say analysts.

The number of Chinese brides receiving diamond engagement rings has risen from about 1 per cent in the early 1990s to 31 per cent in 2010, according to Northland Capital Partners, as the middle class has eschewed traditional jade rings.

However, "it is very difficult for these multi-commodity miners to expand their share of the market," said Ryan Long, Northland's director of equity research. "It makes sense for them to refocus their capital somewhere else where it can be more effective."

Launching the review, Harry Kenyon-Slaney, chief executive of Rio's diamonds and minerals division, said the company had to make sure its businesses fitted with its strategy of operating "large, long-life, expandable assets".

Rio mined about 11.7m carats of diamonds last year, only a fraction of the amount produced by Alrosa and De Beers. Its business is carried on Rio's books at $1.2bn. Analysts valued the unit between $1bn to $3bn, noting that niche diamond groups trade on higher multiples than diversified miners.

Both sales processes could prove challenging, said industry experts. Larger diamond groups could face competition issues, leaving the sale open for smaller miners, such as Lucara Diamond or Petra Diamonds.

Harry Winston, on a market valuation of $1.25bn, could struggle to consolidate the two bigger miners' interests in Canada. KKR and Apollo have also been eyeing the sector, but the relatively mature profile of the mines, with about 10 years or less of production left at Diavik and Ekati on current reserves, could also deter buyers.

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The Short View
James Mackintosh

Investors who bought US shares at the peak of the market in October 2007 were back in profit for the first time for an hour or so yesterday morning, assuming reinvested dividends and no tax.

The rise of the total return version of the S&P 500 to a new high comes as the market is on a roll, with share prices the highest since May 2008.

Bears are, not unreasonably, scanning for the signs of excessive confidence that usually herald the top of the market. The Vix index of implied volatility, Wall Street's "fear gauge", seems an obvious warning: it is at its lowest since June 2007, before the credit crunch began. Taken at face value it suggests that investors are far too sanguine.

But something odd is going on with the Vix. Usually, as shares rise investors become more confident and want less protection against falls. This time investors are cautious, hedging by buying the Vix. Money has been piling into exchange-traded funds that buy Vix futures at a record rate.

This pushed the Vix futures curve to its steepest ever last week. The cost of six-month protection has fallen far less than one-month protection, thanks to the demand. As Orrin Sharp-Pierson at BNP Paribas puts it, a blow-up is still expected, just not in the next month.

Other measures of the options market show investors want to protect their portfolios against losses even as the market rises, the reverse of their usual behaviour. Options skew, the extra cost for bearish puts over bullish calls, is close to a five-year high. The widely watched ratio of puts to calls is high, too, as worry persists.

Survey evidence also suggests investors are not yet overconfident. It is easy to see why. Europe's crisis is far from fixed, US house prices languish at the lowest since 2002 and the Iran stand-off threatens an oil price shock. All this damps bullish sentiment – leaving space for shares to carry on up for a while yet as investors overcome their fears.

www.ft.com/shortview

Gap between oil futures and spot price sparks debate on $100 level

By Javier Blas,
Commodities Editor

Oil contracts for delivery in three to five years' time are trading at their biggest ever discount to spot prices, prompting a debate about whether the era of triple-digit oil prices will be a short-term phenomenon.

Spot oil prices have rallied nearly $20 since the start of the year and traded above $125 a barrel yesterday, on the back of supply disruptions and geopolitical fears over Iran.

Over the same period, oil for delivery in December 2018 has risen $1 to about $95. This has opened a record gap of more than $30 between spot and five-year contracts. "The market has the perception that oil supply will increase in the future and that is holding back the price of forward contracts," said Mark Thomas, head of energy futures at commodities brokerage Marex Spectron, citing expectations of higher output in Iraq, Brazil, the US and Canada.

Saudi Arabia, the world's largest producer of oil, has also pointed to higher supplies emanating from these countries for its belief that current oil prices are "unjustified".

US oil production has surged to a 10-year peak after companies tapped so-called shale reservoirs, using a technique called hydraulic fracturing or "fracking". Energy bankers and analysts believe that forward selling by US companies tapping into the shale revolution has contributed to low future prices.

But many in the industry remain sceptical about a future supply surge. "In our view, oil prices will be significantly higher in the coming years than those implied by the forward curve," said Paul Horsnell, head of commodities research at Barclays.

The International Energy Agency, the western countries' oil watchdog, also warned last year that increased oil production in the US was "unlikely to affect the dynamics of global oil supply significantly".

While the oil price rally partly reflects a tight physical market, the difference between spot and forward prices is bigger than in previous tight markets, such as 2008 and 2004.

Companies and sectors in this issue