25 August 2021

ICMA RESPONSE TO FCA CONSULTATION PAPER CP21/19 ON PROPOSED DECISION UNDER ARTICLE 23D BMR FOR 6 STERLING AND YEN LIBOR SETTINGS[1]

Key points

- Following the announcement by the FCA on 5 March 2021 that the six identified sterling and yen LIBOR settings will no longer be representative and representativeness will not be restored immediately after 31 December 2021, we support the exercise by the FCA of its powers under Article 23D(2) in order to introduce "synthetic LIBOR" for the six identified LIBOR settings.

- In order for synthetic LIBOR to meet its aim of supporting an orderly wind-down of LIBOR, all parties will need to take the same view as the FCA that "synthetic LIBOR remains LIBOR". The legislation that HM Treasury is expected to introduce in order to support contract continuity further will therefore be very important.

- It will also be very important for synthetic LIBOR to be published in the same manner (using the same screens and at the same time) as LIBOR.

Question 1: Do you have any views, information or data which suggest that we should or should not use our Article 23D(2) powers for the 6 LIBOR settings to secure an orderly cessation and to advance our objectives of consumer protection and integrity?

1. Following the announcement by the FCA on 5 March 2021 that the six identified sterling and yen LIBOR settings will no longer be representative and representativeness will not be restored immediately after 31 December 2021, we support the exercise by the FCA of its powers under Article 23D(2) in order to introduce "synthetic LIBOR" for the six identified LIBOR settings.

2. The challenges associated with transitioning legacy LIBOR bonds, particularly in the time available, are well known. We welcome the FCA's recognition of this in the consultation paper, which echoes the Sterling Risk Free Rate Working Group's *Paper on the Identification of Tough Legacy Issues*.

3. We agree with the FCA's analysis that there is likely to be a material amount of legacy bonds outstanding at the end of this year referencing the 1 month, 3 month and 6 month sterling and yen LIBOR settings and which either have no fallbacks or inappropriate fallbacks to deal with the cessation of LIBOR. Many legacy sterling and yen LIBOR bonds contain fallbacks that are likely to result in the disruptive and unintended outcome of fixing at the previous LIBOR rate upon cessation of LIBOR. This is because LIBOR cessation was not envisaged when the terms of most legacy LIBOR bonds were drafted. As noted by the FCA, some legacy LIBOR bonds might contain no fallbacks. Since the date of publication of the FCA's consultation paper, we are aware of a small number of additional successful consent solicitations, but we anticipate that there will still

[1] https://www.fca.org.uk/publications/consultation-papers/cp21-19-proposed-decision-article-23d-bmr-6-sterling-yen-libor-settings

be a material amount of outstanding legacy bonds referencing the six sterling and yen LIBOR settings, by number and value, at the end of this year.

4. We are aware of a very small number of bonds that reference 12 month sterling LIBOR. We are not aware of any bonds referencing 12 month Japanese yen LIBOR, although that does not mean that there are none. It is also possible that other instruments outside of the bond market reference 12 month sterling and yen LIBOR. Overall, we agree that the 1 month, 3 month and 6 month tenors are the appropriate ones over which the FCA should exercise its powers under Article 23D(2) following the FCA's announcement on 5 March 2021, but we note that a synthetic 12 month sterling and yen LIBOR would be helpful for the (possibly small number of) instruments that reference those settings.

5. Given the importance of synthetic LIBOR for the bond market in avoiding the disruptive and unintended outcomes noted above, it will be very important that the market takes the same view as the FCA that "synthetic LIBOR remains LIBOR". The legislation that HM Treasury is expected to introduce in order to support contract continuity further will therefore be very important for English law governed securities and contracts. We note that the legislation will seek to reduce disruption that might arise from LIBOR transition with regard to the potential risk of contractual uncertainty and disputes in respect of contracts that have been unable to transition from LIBOR to another benchmark (so-called "tough legacy" contracts), where the FCA has exercised the powers given to it in the Financial Services Act[2].

6. In addition, it will be very important that synthetic LIBOR can be used by market participants in the same way as LIBOR from a practical perspective. In particular, it must be published on the same screen pages (including authorised distributors' screen pages such as Bloomberg and Reuters) and at the same time as LIBOR is currently published. This is because many LIBOR references in bond market documentation make reference to the rate that is published on a certain screen page as of a certain time and many market participants' systems are programmed to reference the LIBOR rate on those screen pages. Please see further below.

Question 2: Do you agree that a forward-looking term RFR is an appropriate component for producing a 'synthetic' LIBOR to measure on an ongoing basis the expectation of interest rates over a fixed term that is reflected in LIBOR itself?

7. Yes. As noted in our response to Q1 and recognised by the FCA, synthetic LIBOR needs to be available at the start of the interest period so that it can be used in legacy securities and other contracts in the same way that LIBOR is used now. The use of a forward-looking term RFR as a component of synthetic LIBOR is compatible with that.

8. As detailed on IBA's website, the six LIBOR settings are currently published by IBA at 11.55am London time on London business days. We understand that IBA's Term SONIA Reference Rate is published at 11.55am on London business days. We anticipate that this means that a synthetic sterling LIBOR based on IBA's Term SONIA Reference Rate could continue to be published at 11.55am London time on London business days. This will be very important for both contract continuity reasons and operational reasons from the perspective of the market participants that are responsible for referencing LIBOR and making calculations based upon it.

9. We understand that TORF is published at around 5.00pm Japan time on Tokyo business days, which corresponds to 8.00am GMT or 9.00am BST. We therefore anticipate that a synthetic yen LIBOR based on TORF could be published at 11.55am London time. It is not clear whether any

[2] Supporting the wind-down of critical benchmarks - GOV.UK (www.gov.uk)

consideration has been given to potential mismatches between London business days and Tokyo business days, and the possible implications of that for being able to publish synthetic yen LIBOR on all London business days.

10. As noted in our response to Question 1, it is also important from a legal and practical perspective that synthetic LIBOR continues to be published on the same screen pages (including authorised distributors' screen pages such as Bloomberg and Reuters) as LIBOR is currently published.

Question 3: Do you agree that the fixed spread adjustment that applies as part of the ISDA IBOR fallbacks for the relevant LIBOR currency and tenor setting and that is published for the purpose of the ISDA IBOR Fallbacks Supplement and Protocol is the fairest and most robust way to calculate the replacement value for LIBOR?

No ICMA response

Question 4: Do you have any representations or points about how our proposed 23D(2) decision would impact you?

11. As noted above, we are supportive overall of the introduction of synthetic LIBOR for the identified settings in order to support an orderly wind-down of LIBOR. There are several connected questions for the bond market:

    a. *International consistency:* An orderly wind-down of LIBOR will require market participants to accept the synthetic versions of sterling and yen settings for use in legacy securities and contracts from the end of 2021, while continuing to reference panel-bank US dollar LIBOR until mid-2023.

    b. *Contract continuity:* As noted above, the legislation that HM Treasury is expected to introduce in order to support contract continuity should help market participants accept that "synthetic LIBOR remains LIBOR", as stated by the FCA. In addition, the importance of publishing synthetic LIBOR in the same manner as LIBOR cannot be overstated. In particular, it must be published on the same screen pages (including authorised distributors' screen pages such as Bloomberg and Reuters) and at the same time as LIBOR is currently published.

    c. *Availability of synthetic LIBOR*

        i. As outlined in our response to the FCA's CP 21/15, it will be very important that the FCA grants UK supervised entities a broad permission to use synthetic LIBOR for legacy LIBOR bonds. Without this, significant legal and practical uncertainty will arise.

        ii. In addition, we note that the synthetic yen LIBOR settings will be made available for one year and the synthetic sterling LIBOR settings will be made available for a maximum of 10 years, subject to biennial review. It will be important for the FCA to take into consideration the remaining number and volume of outstanding legacy bonds and other instruments referencing sterling LIBOR and the implications of withdrawing synthetic LIBOR during those regular reviews. We note that other legislative solutions aimed at securing an orderly wind-down of LIBOR (e.g. New York State legislation relating to USD LIBOR exposures) do not have a time limit.

        iii. In terms of the availability of synthetic LIBOR for use in *new* instruments, we note the prohibition contained in the UK Benchmarks Regulation. New issues of sterling floating rate bonds have been referencing SONIA for some time now.