FCA FINANCIAL CONDUCT AUTHORITY

12 Endeavour Square
London
E20 1JN

Tel: +44 (0)20 7066 1000
Fax: +44 (0)20 7066 1099
www.fca.org.uk

Scott O'Malia
Katherine Darras
International Swaps and Derivatives Association, Inc.

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Dear Scott, Dear Katherine

ISDA's 4 December 2019 letter to FSB co-chairs Andrew Bailey and John Williams asked if the FCA and ICE Benchmark Administration (IBA) could give further clarity about the length of any "reasonable period" in which a non-representative LIBOR might be published prior to LIBOR's final cessation. I understand that ISDA, and its members, would be concerned if a non-representative panel bank LIBOR were published for more than a few months.

I am replying on behalf of the FCA to describe the laws relevant to this situation and provide clarity on how the FCA intends to apply them.

I set out below why market participants should not assume that any period of non-representative LIBOR based on reduced panel bank submissions would last for more than a short period (i.e., a period of months, not years).

Before giving more detail however, I want to underline the FCA's previous statements that our preference is for an orderly cessation of LIBOR in which its discontinuation is pre-announced, market participants have prepared for this, and publication of a non-representative LIBOR is avoided.

The four-and-a-half-year transition period set out in July 2017[1] is intended to make this achievable and you're aware of the huge amount of work that has gone into transition from both market participants and the international official sector. The authorities involved are very grateful for the crucial role ISDA itself has played in these efforts.

However, we have also made clear in other letters and published speeches that the LIBOR "end-game" may play out in other ways[2]. We have urged firms to recognise the possibility of a non-representative LIBOR being published for a period of time prior to final cessation; and encouraged ISDA to provide derivatives market participants with the ability to insert pre-cessation fallback triggers into their derivative contracts to prepare for this. No firm should rely on the expectation that a non-representative LIBOR will be published, but they should understand this possibility and, where they can, avoid being exposed to it.

[1] https://www.fca.org.uk/news/speeches/the-future-of-libor
[2] https://www.fca.org.uk/news/speeches/next-steps-transition-libor

The law governing critical benchmarks such as LIBOR is set out in the EU Benchmarks Regulation (the EU BMR). The UK Government has 'onshored' the EU BMR on to the UK statute book (the UK BMR). The UK BMR is set to come into force on the day the UK leaves the European Union. Should the Withdrawal Agreement Bill be passed and receive royal assent, the EU BMR will continue to apply in the UK until the end of the implementation period, and the UK BMR will come into force at the end of this period (31 December 2020). As a result, regardless of Brexit, the Benchmarks Regulation is critically important to how the end of LIBOR will be governed.

Notwithstanding our preference for an orderly cessation, planned in advance, the mechanics of the BMR mean that the we cannot rule out the publication of a non-representative LIBOR, at least for a period of time. This could happen, for example, after end-2021 if some but not all panel banks withdrew from the LIBOR panel, leaving too few submitting banks that are sufficiently active in the relevant underlying markets, for the rate to be capable of being representative of those markets.

The FCA thinks a non-representative panel bank LIBOR would be a very uncomfortable situation for LIBOR users. The behaviour of the rate would be difficult to predict, the level could be impacted by any significant change in panel composition, and it is likely to be more volatile given the smaller number of panel banks. We would expect appetite to buy or continue to hold LIBOR-referencing instruments to diminish very significantly. Indeed, EU-supervised firms could potentially be prohibited from entering into new LIBOR transactions, and even from continuing to use LIBOR in existing transactions in some circumstances, under the BMR. We think it would be difficult for CCPs to continue to clear LIBOR-referencing transactions under these circumstances for risk management and regulatory reasons. LCH has made a public statement to this effect[3].

Partly because of these concerns, the BMR does not envisage an ongoing market in non-representative benchmarks. In other words, it does not envisage the publication of a non-representative benchmark as the long-term solution for markets that hitherto relied on that benchmark. Article 11(4) of the BMR refers to the administrator ceasing to provide the benchmark (or changing the benchmark to restore representativeness) within "a reasonable time period". The FCA has made clear that it sees no way of changing LIBOR to make it representative again after panel bank departures have rendered it non-representative. Consequently, the only way we see this provision operating in practice is that the administrator must cease the rate within a reasonable time period.

Moreover, a non-representative panel bank LIBOR could continue only for such time as a minimum number of panel banks were prepared to continue contributing to the benchmark such that IBA's Reduced Submissions Policy did not apply. The FCA has made clear that we have no plans to compel panel banks to contribute once our existing voluntary agreement with them expires.

Based on our conversations with a number of the panel banks, we anticipate limited willingness to contribute to a non-representative LIBOR for anything longer than the minimum period necessary to allow for an orderly cessation, in line with the BMR. While this would be a decision for each panel bank to take individually, we presume that as active participants in the derivatives markets they will share the concerns of other derivative market participants about the ongoing publication of a non-representative, panel bank LIBOR for more than a short period of time, and will take this into account when making their decisions about whether to continue submitting.

It is also our understanding that IBA as administrator of LIBOR would not be comfortable publishing an unrepresentative benchmark, and recognises that the administrator must cease to publish the benchmark within a reasonable time period if it can no longer be produced in a representative way.

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[3] https://www.lch.com/membership/ltd-membership/ltd-member-updates/lchs-position-respect-pre-cessation-triggers-relation

Notwithstanding these views, under Article 21(1) of the BMR, IBA must give notice to the FCA when it intends to cease providing LIBOR, and may not cease publication within 4 weeks of such notice. Article 21(2) sets out a further 4-week period in which the FCA is required to make certain assessments, and during which IBA could not cease publication without written consent from the FCA. Article 21(3) gives the FCA the power to compel IBA to continue production until the benchmark "can be ceased in an orderly fashion[4]".

I note ISDA's concerns about the downsides of an unrepresentative panel based LIBOR being published for more than a few months. Consistent with our having no plans to compel panel banks to contribute after 2021, assuming insufficient willing voluntary contributors, the FCA would not expect to compel IBA under Article 21 to continue to produce a non-representative panel bank LIBOR.

The many years of advance warning of LIBOR's demise means that firms have had the opportunity to implement transition plans. The FCA would not seek to prolong a non-representative panel bank LIBOR simply to benefit firms which had failed, or continued to fail, to act on opportunities to transition. Where contracts can practicably be amended to reference alternative rates by bilateral agreement or other arrangements, they should be, before end-2021.

EU supervised firms are required by the BMR to have appropriate plans in the event that a benchmark materially changes or ceases to be provided. As a policy matter, we believe this requirement covers the possibility that a benchmark's supervisor could declare it no longer capable of being representative, and so firms need a plan for this. In our view firms can meet this requirement by having pre-cessation triggers included in LIBOR contracts that cannot be proactively transitioned away from the rate.

The FCA recognises that there are some LIBOR-referencing contracts that it is not practicable to change, and I am chairing a taskforce under the Sterling Risk Free Rate Working Group dedicated to the topic of 'tough legacy' (in which ISDA is helpfully participating). Notwithstanding this work to understand this issue better, the FCA has been unequivocal in many previous statements that the FCA has no plans to use our powers to sustain panel bank LIBOR beyond end-2021 for the benefit of 'tough legacy' contracts. Those statement apply regardless of representativeness.

I hope this provides the necessary clarity and reassurance on the FCA's position in response to your letter.

Yours sincerely,

Richard Fox
Head of Markets Policy
The Financial Conduct Authority

[4] Or ceases to be critical, or the benchmark is transitioned to a different administrator.