THE
INVESTMENT
ASSOCIATION

Response to FCA consultation

Winding down 'synthetic' sterling LIBOR and US dollar LIBOR

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 270 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £9.4 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 44% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

Executive summary

The IA is grateful for the opportunity to respond to the *FCA consultation paper CP22/11: Winding down 'synthetic' sterling LIBOR and US dollar LIBOR*. As stated in our response to CP21/22, ensuring that transition plans are appropriate and aligned with other jurisdictions to reflect the global nature of financial markets in which many of our members operate in is crucially important.

The IA would welcome the opportunity to further discuss the points raised in this response should the FCA deem it useful.

3. Synthetic sterling LIBOR

Q1: Do you agree that the 1-month sterling LIBOR setting can be ceased in an orderly fashion at end-March 2023?

IA members considers that overall, for the majority of instruments that reference the 1-month sterling LIBOR setting it can be ceased in an orderly fashion by end-March 2023. It is the understanding of our members that there are a relatively small number of instruments referencing 1-month synthetic sterling LIBOR, and we do not anticipate any unintended consequences arising from the cessation of this tenor that would negatively impact the market, particularly the end-investor. However, this understanding is anecdotal and without the publication of concrete data outlining the amount and type of bonds referencing the 1-month setting which have a maturity beyond March 2023, there is still a risk that potentially some/more bonds may be impacted by the cessation of this tenor.

IA members have continued to reduce their exposure to the 1-month rate as it has always been clear that synthetic rates would be a temporary solution in the transition away from LIBOR to new risk-free reference rates which are better placed to promote and enhance the integrity of the UK financial system.

Ultimately, cessation of any LIBOR setting is reliant on issuers transitioning away from these rates. The transition away from the 1-month synthetic setting is therefore dependent on whether the issuers of those instruments continue to reference the synthetic LIBOR rate or not. Whilst the buy-side will continue to engage with issuers to encourage full transition and will continue to support efforts to move away from synthetic LIBOR, regulators should consider how best to apply pressure to issuers that do not show a willingness to do so.

It should be noted that direct engagement between issuers and individual note holders is limited due to the potential for any response from issuers to be deemed material/price forming etc. which would require noteholders who receive such information to take themselves off-market or risk breaching market abuse regulations. As such, whilst noted above the buyside will continue to engage with issuers to encourage transition, there is a limit to what issuers and bondholders can meaningfully discuss in bilateral conversations without the bondholder taking themselves off-market, or the issuer making their plans public.

Q2: Do you agree that the 6-month sterling LIBOR setting can be ceased in an orderly fashion at end-March 2023

The considerations outlined in our response to Q1 also apply to the cessation of the 6-month sterling LIBOR setting by end of March 2023.

Again, it is our understanding that there are a relatively small number of instruments referencing the 6-month synthetic sterling LIBOR rate. Whilst our members do not anticipate any unintended negative consequences arising from the cessation of this tenor for most instruments by the FCA's proposed deadline, we caveat that without publication of the data outlining the number of bonds that reference this rate beyond March 2023, it is difficult to offer certainty that no instruments will be impacted. For example, some of our members raised concerns over the possible impact the cessation of the 6-month sterling LIBOR rate could have on a subset of tough legacy structured finance and securitisation products with more complex arrangements, where despite continuous engagement with issuers it has been impossible (to date) to transition these instruments to an alternative risk- free rate. As a result, should the 6-month sterling LIBOR setting cease publication at the end of March 2023 and legacy stock cannot or has not been transitioned to the new risk-free rate, the IA seeks that the FCA provide confirmation that such noteholders would not be viewed negatively by the regulator in terms of their senior management responsibilities, given the note holder is not in a position to amend the terms of the contract.

IA Members would like to take this opportunity to assure the FCA that they have put in place the necessary projects and processes to transition away from instruments referencing this setting and will continue to engage with the regulator to ensure the effective functioning of the financial markets throughout the process. Again, as noted in our response to Q1, a successful cessation of the 6-month rate, and transition to the new rate, will be dependent on issuers putting in place and implementing plans to transition these instruments, a process to which buyside firms have limited ability to control/influence.

Q3:

a. **Are there any reasons why you – or, if you are a trade body or professional services firm, your members or clients will not be able to transition your 1 –**

and/or 6- months sterling LIBOR exposures in the manner and timeframe we have assumed possible?

As noted in our response above, for the most part we do not expect there to be any significant hurdles on the part of our members to transitioning away from the 1- and 6-month synthetic sterling rates. However, our members do stress that in terms of tough legacy bonds (particularly securitisations) that reference 6-month sterling LIBOR it may not be possible to transition these bonds within the timeframe set out by the FCA.

Furthermore, as outlined in our response to Q1 and Q2, transition will be largely dependent on the willingness and ability of issuers to put in place and implement plans to transition instruments still referencing LIBOR.

b. **Where the answer is Yes, what asset class(es) and/or types of contract(s) do these exposures relate to, and which LIBOR setting do they reference?**

N/A.

c. **Please explain why these exposures cannot be transitioned in the manner and timeframe we've assumed to be possible, and what alternative timescale do you think is needed**

N/A.

Q4: In your view, when would be the earliest date at which the 3-month sterling LIBOR setting could cease in an orderly fashion

The IA supports the FCA's decision to consult with the industry on when the 3-month sterling LIBOR setting could be terminated to prevent discord within the market. IA members understand that significantly more bonds reference the 3-month synthetic sterling LIBOR setting compared to the 1-month and 6-month synthetic sterling rate. In particular, our members note specific complexities in relation to securitisation and retail mortgages which are known to reference the 3-month sterling LIBOR setting.

Further to the above, in terms of tough legacy instruments with more complex arrangements (such as securitisations or repackagings) where the originator or sponsoring entity no longer exists or is insolvent and, or, where economic interest in the transaction has been sold to a third party, the act of transition becomes far more difficult as there is no longer a decision maker or a party willing to assume the cost of amendment.

As a result, IA members advise that the 3-month synthetic LIBOR rate ***continue*** to be published beyond March 2023 in order to prevent disorderly functioning of the market. In order to ensure fair and consistent outcomes for all customers including those with tough legacy exposures, IA members consider that it may not be in the best interests of the industry to cease publication of the 3-month synthetic LIBOR setting anytime in the near future.

Q5:

a. **Do you – or, if you are a trade body or professional services firm, your members or clients have exposure linked to 3- month sterling LIBOR where you have encountered, or expect to encounter, obstacles that prevent you from completing transition by end-March 2023**

Further to our response to Q4, the experience of our membership suggests that the greatest challenge buyside clients face in terms of transition in both the near and medium term are not in relation to structural changes, but the lack of engagement witnessed by market participants amongst some individual non-regulated counterparties in the repapering of contracts to reference the new risk-free rate.

b. Where the answer is Yes, what asset class(es) and/or types of contract(s) do these obstacles relate to?

As mentioned in our response to previous questions the consent solicitation process for bonds (including securitised assets) needs to be initiated by the issuer. IA members as part of their detailed transition plans have engaged with issuers to encourage transition but ultimately the process is dependent on issuers.

As noted in the response to Q1, unlike other, private (e.g. loans) instruments, there are well established market abuse regulations which members are required to follow in terms of engagement with these issuers, therefore for public bonds generally issuers are hesitant to confirm if and when they have distinct plans for active conversion, for fear of disseminating material non-public information. In accordance with MAR and in the context of non-public price forming information public instrument issuers do not provide any information to specific investors beyond what is announced via public channels which limits the role IA members (and the wider buyside community) can play in supporting transition.

c. Please provide details of these obstacles, how you intend to overcome them and to what timescale?

IA members have put in place detailed plans to deal with the transition of legacy GBP LIBOR portfolios and are well progressed in implementing their plans. Our membership along with the wider buyside community have demonstrated a considerable amount of engagement to support an orderly transition away from an unrepresentative benchmark.

As part of their transition plans IA members are conducting risk analysis of the legacy documents held within their portfolios and documentation. Independently IA member firms will need to make an assessment, on the limited information available, on how confident they are that issuers will have transitioned the instruments within specified timelines. If they lack confidence in transition, they will likely prioritise such instruments but will also need to consider the consequences of the instrument not transitioning and the impact on their portfolio. Should members be concerned by an issuer's transition plans (or lack thereof) members may be forced to exit those positions en masse which may lead to a disorderly market in remaining GBP linked LIBOR instruments.

Again, The IA seeks assurance from the FCA that should the circumstance arise where an instrument cannot be transitioned to the new risk-free rate despite engagement between regulated noteholder with the issuer, that these noteholders would not be viewed negatively by the regulator in terms of their senior management responsibilities given the noteholder is not in a position to amend the terms of the contract.

Q6:

a. **Do you – or, if you are a trade body or professional services firm, your members or clients – have any specific contracts, or classes/types of contracts, linked to 1-, 3-, or 6-month sterling LIBOR that you consider will be unable to cope with cessation regardless of the time available – because they do not have workable fallbacks, cannot be transitioned away, and cannot cease prior to maturity without causing disruption?**

As outlined in our responses above, The IA understands that a relatively small number of instruments reference the 1-month synthetic sterling LIBOR rate and so we do not anticipate any unintended negative consequences arising for the buyside community with its cessation at the end of March 2023. However, without publication of the data outlining the amount of bonds referencing the 1-month setting with a maturity beyond 2023, IA members are cautious that some bonds may be impacted by the discontinuation of this setting.

In terms of the termination of the 3-month and 6-month sterling LIBOR setting, the IA highlights that there is a subset of tough legacy contracts (particularly in relation to securitisation, repackagings and structured finance products) with more complex arrangements e.g. where the originator or sponsoring entity no longer exists or is insolvent and, or where economic interest in the transaction has been sold to a third party, making transition away from these LIBOR settings far more difficult, as there is no longer a decision maker or a party willing to assume the cost of amendment.

b. **Where the answer is Yes:**

i. **What type of contract(s) are they?**
ii. **Which LIBOR setting(s) do they reference?**
iii. **What is their approximate total value?**
iv. **When are they due to mature?**

c. **For each type of contract, please explain the precise reasons why you consider they cannot transition, and what the impact on the contract would be if the relevant sterling LIBOR setting ceased**

4. US dollar LIBOR

Q7: Do you agree it will be possible to transition remaining exposures to US dollar LIBOR in line with our assumptions?

IA members note that the data available to the public illustrates that there is approximately an equal number of USD LIBOR referenced bonds issued under US law as there is under English law. Thus, the IA would recommend the introduction of a temporary synthetic USD LIBOR rate (by 2023) for certain tough legacy instruments, providing a bridge to transition for issuers of these instruments with the understanding that any such rate would not be permanent and would be subject to regular review. Providing a synthetic rate would also help align the UK's approach with the approaches being taken in other jurisdictions such as the US and the EU where there is no legislative time limit imposed on fallback support.

If a fall-back rate were to be introduced, it should mirror the approach taken in the US whereby under federal US law a floating rate was introduced. Introducing a fixed rate in the UK for USD LIBOR settings would cause widespread fragmentation within the market.

We also anticipate that there may be fewer UK regulated issuing entities of US dollar LIBOR under English law, suggesting that UK regulatory pressure alone may not be sufficient enough to persuade these issuers to actively transition away from USD LIBOR ahead of its official termination. The introduction of a synthetic rate may bridge this gap offering the industry a smoother transitional experience.

The IA and its members strongly encourage regulators across the globe to work together to align their approach on the transition of US dollars LIBOR contracts given the international nature of the markets.

A common approach to the treatment of US dollar LIBOR will ensure that firms (many of which operate globally), undertake a quicker and safer transition from reliance on an unsustainable benchmark to a more robust financial system.

Members also highlight that to date not only does the USD LIBOR legacy population remain large, but there are also several nuances associated with the transition of USD LIBOR, including but not limited to, concerns surrounding credit sensitive rates and their role in the overall transition process and the lack of transition (to date) within legacy stock.

As a result of the above, IA members consider that some specific issues may not yet have been identified by market participants, another reason the introduction of a synthetic rate would be extremely beneficial.

IA members remain committed to transition away from US dollar LIBOR rates to the new SOFR rate and will continue to follow the latest guidance set by the regulators

Q8:

a. **Do you – or, if you are a trade body or professional services firm, your members or clients – have exposures to US dollar LIBOR where you have encountered, or expect to encounter, obstacles that prevent you from completing transition by end-June 2023?**

Differing approaches from regulators create difficulties for IA members and ultimately slow the transition process. We would like to reiterate our strong support for a globally aligned response from regulators on the transition of US dollar LIBOR, which would help foster a common and orderly approach to obstacles that firms may encounter during the transition process.

Furthermore and as noted in our response to Q7, IA members highlight that to date not only does the USD LIBOR legacy population remain large, but there are also several nuances associated with the transition of USD LIBOR, including but not limited to, concerns surrounding credit sensitive rates and their role in the overall transition process, and the lack of transition within legacy stock (to date). This, coupled with the fact that the timeline for transition away from GBP LIBOR was shorter than that of USD LIBOR, significantly increases the risk of disorderly transition particularly without the introduction of a synthetic rate.

IA members continue to focus their attention on the transition of USD LIBOR and anticipate that some specific issues may not yet have been identified by market participants.

b. Where the answer is Yes, what asset class(es) and/or types of contract(s) do these obstacles relate to?

The IA anticipates that index tracker products that contain securities referencing US dollar LIBOR without fallback options will be difficult to transition.

c. Please provide details of these obstacles, how you intend to overcome them and to what timescale?

The IA and its members will continue to engage with issuers on how best to transfer out of US dollar LIBOR contracts. The IA members welcomes guidance from the FCA on this matter, and found the clarity provided by timelines set by the FCA for past LIBOR milestones to be extremely helpful.

d. Where these contracts are governed by laws other than US or UK law, please provide details of any contract language or provisions that mean our assumptions are not appropriate and require adjustment?

Q9:

a. Do you- or, if you are a trade body or professional services firm, your members or clients – have any specific contracts, or classes/types of contracts, linked to US dollar LIBOR that you consider will be unable to cope with cessation regardless of the tine available – because they do not have workable fallbacks, cannot be transitioned away, and cannot cease before maturity without causing disruption?

As noted in our response to Q8(b), the IA anticipates that index tracker products that contain securities referencing US dollar LIBOR without fallback options will be difficult to transition.

b. Where the answer is Yes:

- **i. What type(s) of contract(s) are they?**
- **ii. Which LIBOR setting(s) do they reference?**
- **iii. How many contracts are there?**
- **iv. What is their approximate total value?**
- **v. When are they due to mature?**
- **vi. What is the relevant governing law?**

c. For each type of contract, please explain the precise reasons why you consider they cannot transition, and what the impact on the contract would be of the relevant US dollar LIBOR setting ceased?

Q10: What impact would publication of a synthetic US dollar LIBOR rate have? Would there be any unintended adverse consequences?

Although the IA's members have already dedicated a considerable number of resources to make the changes needed to transfer to new risk-free rates worldwide, we would recommend the publication of synthetic US dollar LIBOR rate to assist the industry with the orderly phasing out of US dollar LIBOR for tougher legacy contracts.

The FCA's decision to publish synthetic sterling LIBOR at the start of the year greatly helped with the orderly transition of legacy contracts, and firms have continued to make necessary changes throughout the year to reduce their reliance on this temporary solution. We would like to echo our support for an aligned response from regulators and would strongly support the introduction of synthetic US dollar LIBOR rates within the UK. Should all regulators assume the same approach this would ensure international alignment and consistency in the transition process, illustrating how globally all market players and jurisdictions can work together to improve market practices.

Please provide details of what and whether this is relevant to specific contracts

Once again, The IA and our members caution that for a minimal subset of tough legacy bonds transition away from LIBOR may be unobtainable.