Opening remarks from Toby Williams at AFME/IMN Global ABS on 17 September 2021 – IBOR Transition: How Ready are We for 2022?

Thank you, Morgan [Krone – Moderator]. I'm Toby Williams. I work at the FCA, in the Benchmarks Policy team within the Markets and Wholesale Policy Division.

Good morning, afternoon, evening, wherever you are in the world. And thank you to AFME and IMN for hosting this event, it's a pleasure to be here in such company and thank you for inviting me to speak today.

We are entering the final stages of LIBOR transition, nearing the sprint to the end of the year. To which I'd like to recognise and praise industry for the incredible effort that has gotten us to this point.

There is now just over three months to go until the end of LIBOR as we know it. The taps of new sterling LIBOR flow have largely been turned off, starting with bonds, loans and linear derivatives from March and then non-linear derivatives and exchange traded derivatives from June. The focus since then has been on reducing the existing stock of LIBOR contracts. Your plans to complete transition should be well under way.

Firms should act now

You cannot and should not wait. You should prepare your contracts for transition either through fallbacks or active conversion. If we take the example of consent solicitations in the bond market, these require holder approval as well as the not insignificant work of multitudes of teams. As we approach the end of year, resource may be booked up. You will not be the only ones looking for legal, accounting or systems expertise. You may need to go to your board for approval. The time is now to have timelines and clear plans in place.

Likewise, if you are intending to use market prices to enable transition, you need to be aware of the evolving market conditions as we approach the end of the year. Liquidity continues to move from LIBOR to SONIA in many markets. The effects of this should not be ignored.

Synthetic vs RFRs

Turning briefly what to we at the FCA are doing to support an orderly year-end.

We have now consulted on what a potential synthetic LIBOR would look like for relevant sterling and yen settings. We have long signalled what this is likely to be, the relevant term risk-free rate plus a fixed credit spread. We will confirm our final decisions in due course, but I know the key question on everyone's minds is which contracts will be permitted to use these rates?

We will soon launch a short consultation on exactly which legacy contracts will be able to use any synthetic sterling and yen LIBOR settings. It is vital that firms respond to this consultation; we want to hear from everyone on this. Not just UK based or regulated firms. We will confirm our final decisions as soon as practicable following our consultation. As I'm sure you will all have seen, Her Majesty's Treasury (HMT) have also recently introduced a new bill which provides contractual continuity for users of those synthetic settings. This would make clear that a synthetic LIBOR rate should be treated as LIBOR in existing contracts.

However, our key message is that market participants should be amending their contracts wherever practicable and should not be waiting for the synthetic solution. Synthetic LIBOR should be seen as a "bridging solution" only.
For those legacy contracts that are permitted to use synthetic LIBOR, it would simply give them an extra time-limited period to move away from LIBOR permanently. It doesn't remove the need for firms to act; that is to complete active conversion to alternative rates, or otherwise adopt robust fallbacks.

SONIA compounded in arrears is expected to be the new centre of gravity in sterling markets, as will be the case for risk-free rates more generally worldwide. Compounded in arrears is the most robust form these rates take. Synthetic LIBOR will not give you the benefits of converting to overnight rates compounded in arrears – like operational efficiencies from having all your products on the same rates, higher liquidity, and lower hedging costs. But you can get there through active conversion.

Any synthetic rate would only be for a time-limited period and may not be the preferred economic outcome for all LIBOR users. Market participants are encouraged to amend their contracts where they can in line with the milestones of the Risk-Free Rate Working Group.

USD transition

Now I'd like to talk a little bit about US dollar transition.

From the end of the year there should be no new use of US dollar LIBOR. This has been supported by regulators globally and from the top of the regulatory pyramid at the Financial Stability Board, the FSB. For FCA regulated firms, we will be monitoring this closely and firms should expect supervisory questions and scrutiny if making new use of dollar LIBOR after the end of the year. This is set out in our March Dear CEO letter. Although at a high level it appears that US dollar transition is following a distinct path from other currencies. It is similar to the path trodden in sterling, with distinct dates for ceasing new use ahead of a period to bring down the legacy stock of outstanding contracts.

We have seen stellar progress in the dollar derivatives market following the SOFR first initiative. This was one of the biggest efforts so far in LIBOR transition; a truly global push. This initiative was focussed on the interdealer market, which we now believe to be above 90% SOFR based. Our experience of the SONIA first initiatives in sterling suggests that the increased liquidity will filter through to dealer to client pricing and eventually a tipping point will be reached; where new flow in SOFR becomes greater than LIBOR.

The uptake of SOFR in the swaps market has paved the way for the ARRC to formally recommend CME's term SOFR rate, knocking down another barrier that has been used to justify slow transition.

Now to **Use of Term Rates**

Term rates are now being produced in both sterling and dollar markets. And in both markets, suitable limited use cases have been developed by industry groups. That is the ARRC in the US and the Risk-Free Rate Working Group and the FMSB in the UK. If I take bonds and securitisations as an example, the FMSB outlined that use of a term SONIA rate in bonds would require a robust rationale due to the systemic risk that excessive use of term SONIA would create. The sterling bond market has shown that forward looking rates are not required, we would not expect this to materially change over time.

It is important to remember that each use case has been developed with its own currency and its nuances in mind. The ARRC guidance does not overrule anything produced by the FMSB or Risk-Free Rate Working Group nor vice-versa.

Credit Sensitive Rates

On the subject of alternative replacement rates, a cornerstone of LIBOR transition has been to move to the most robust rate possible. In the majority of cases that will be risk-free rates compounded in arrears. We do not want to go through an exercise similar to LIBOR transition in the future. This whole endeavour has been to make markets safer and stronger. Significant progress has been made at not insubstantial cost; we cannot re-embed the same frailties.

The FCA have been clear in our views on use of so-called "credit sensitive rates", that some are suggesting could be potential replacements for US dollar LIBOR; as have The Bank of England and US regulators. Additionally, IOSCO has put out a statement that should leave no doubt on the risks that credit sensitive rates entail.

Firms thinking about using these rates should also consider carefully the conduct risks involved and make sure their clients are also aware of these risks. UK regulated firms should speak to their FCA supervisors first.

Now to **Robust fallbacks**

Looking ahead to both new use and choices made through active transition of legacy, choosing the most robust rate is a key part but does not complete the process. It is prudent that contracts include robust fallbacks as well, no matter the primary rate that is selected. This is actually a requirement for firms subject to the Benchmarks Regulation in both the UK and EU. These fallbacks should cater for cessation as well as material changes to the benchmark and offer certainty on the replacement rate wherever possible.

Where a fallback rate could be subject to the same vulnerabilities as the primary rate (and therefore possible material change), we think the fallback is unlikely to meet this standard. The market has made huge strides in fallback development since the FSB began its work on interest rate benchmark reform; it is important these continue to be put to use.

Robust rates and robust fallbacks are not an either or, you will need both.

In **Conclusion**

This is probably the most significant transformation in interest rate markets, if not all markets, that we will see in our lifetimes.

We would encourage you to do this properly. I'm sure you have no desire to repeat the exercises, sometimes costly ones, of the recent years. We urge you to gravitate towards the far more robust compounded or averaged RFRs rather than less robust alternatives.

Market participants have achieved so much already in LIBOR transition. So, let's continue this momentum and make this final push to deliver stronger financial markets.

I'll finish there with my opening remarks.