UK FINANCE

16th January 2020 UK regulators and RFR WG communications to accelerate LIBOR transition – for member use only

Dear Member,

The UK Risk Free Rate Working Group (RFR WG), Prudential Regulation Authority (PRA)) and Financial Conduct Authority (FCA) published several documents today to encourage the industry to accelerate the LIBOR transition.

1) Letter to Senior Management Function (SMF)

The PRA and FCA this morning sent a letter to SMFs within firms setting out supervisory expectations with regards to the LIBOR transition in 2020. It contains a clear steer that the transition should accelerate, reiterating a statement from the Bank of England's Financial Policy Committee that '*The intention is that sterling LIBOR will cease to exist after the end of 2021. No firm should plan otherwise*.'

The letter invites firms to reflect three project milestones in their LIBOR transition plans:

- Switch from LIBOR to SONIA for sterling Interest Rate Swaps (IRS) as the market convention by 2 March 2020. The FCA and PRA said they have identified this date as appropriate following discussions with market makers. A separate statement was issued to reaffirm commitment to this timeline;
- Cease issuance of cash products linked to sterling LIBOR by end-Q3 2020. (Note that the published RFR WG project milestone includes the important additional qualification that the cessation of issuance should apply to sterling LIBOR cash products *maturing beyond 2021*, recognising that certain cash products with shorter maturities are not expected to have suitable alternatives available at end Q3 2020); and
- Significantly reduce the stock of sterling LIBOR referencing products by Q1 2021.

The letter also says that firms should incorporate in their planning from Q1 2021 action in four areas i) product development, ii) reviewing infrastructure, including updating loan system capabilities, iii) client communications and awareness and iv) updating documentation. It notes that firms' LIBOR transition plans should include the targets in project milestones and ensure that management information is available to track progress.

The letter concludes that the FCA and PRA will step up their engagement with firms to monitor progress.

2) A paper on use cases of benchmark rates: compounded in arrears, term rates and further alternatives

The RFR WG published a paper developed by the Term Rate Use Case Task Force relating to considerations of where the usage of SONIA compounded in arrears is appropriate and guidance on where the usage of alternative approaches, such as SONIA term rate, may be necessary.

To determine the appropriateness of rates, the RFR WG segmented the market according to the structure and characteristics of products and the operational capability and sophistication of the borrower or end users.

The Task Force focused on loans and other cash products, noting that SONIA overnight and compounded in arrears was widely adopted or adoptable in the derivatives and bond markets.

For loans, the Task Force considered that use of SONIA compounded in arrears was appropriate for approximately 90% of new loan deals by value and that alternative rates would likely be required for 10% of new loan deals by value.

The paper contains a decision tree to help inform if SONIA compounded in arrears is appropriate for some clients where further consideration may be helpful. Three other areas of the market are called out as requiring alternative rates: i) trade and working capital products such as supply chain finance, ii) export finance/ emerging markets and iii) Islamic facilities (page 9 of report).

For loans, the paper states that “more sophisticated borrowers” are capable of borrowing in markets linked to overnight SONIA compounded in arrears and are likely to be capable of understanding the benefits, risks, and potential costs.

It notes however that “smaller corporate, wealth and retail clients” for whom simplicity and/or payment certainty is a key factor, may wish to consider alternative rates. A table gives an indication of a threshold that may be considered to scope this population, indicatively comprising mid- corporates with annualised revenue between £6.5m and £2.5m revenues, or SMEs below £6.5m revenues.

Products	Client Breakdown	Details	Definition	Balance %	Recommended Rate
Bonds/ Loans/ Trade	Large Corporate/ Leverage	Sponsor/ Leverage Large Corporate	Corporate deals/ Sponsor lead acquisitions/ recapitalisations with a deal size £25m	50%	Compounded in Arrears
Loans/ Trade	Mid to Large Corporate/ Specialist Finance	Financial Institutions	Banks, insurance providers, asset managers, funds, hedge funds and broker dealers	40%	
		Mid to Large Corporates	Annualised revenue >£25m and deal size £10-£25m.		Compounded in Arrears
		Social Housing	Lending to Social Housing firms		Compounded in Arrears
		Education/ Local Authority	Lending to schools/ Higher Education/ Local Authorities		
		Project Finance	Financing of a major independent capital investment		
		Real Estate	Commercial Real Estate firms		
	Export Finance/ Emerging Market	Export Finance	Funding to outsized capital expenditure with export finance guarantee	10%	Term/ Alternative Rate
		Emerging Markets	Lending to emerging markets		
	Mid Corporate/ Private Banking & Retail	Mid Corp	Annualised revenue >£6.5m and <£25m. Excludes specialised lending		Term/ Alternative Rate
		Small, Micro Size Enterprise	Annualised revenue <£6.5m		
		Retail Mortgages	Retail clients		
		Wealth/ Private Bank	Offers Banking and affluent clients, families and fiduciaries based in the UK, offshore or emerging markets		
Product Exception	Trade & Working Capital	Trade & Working Capital	All Trade & Working Capital products including discounting/ Letters of credit, supply chain finance etc		
	Islamic Finance	Islamic Finance	Islamic facilities forbid interest payments on loans		

The document contains a disclaimer saying that the paper does not constitute guidance from the FCA and PRA.

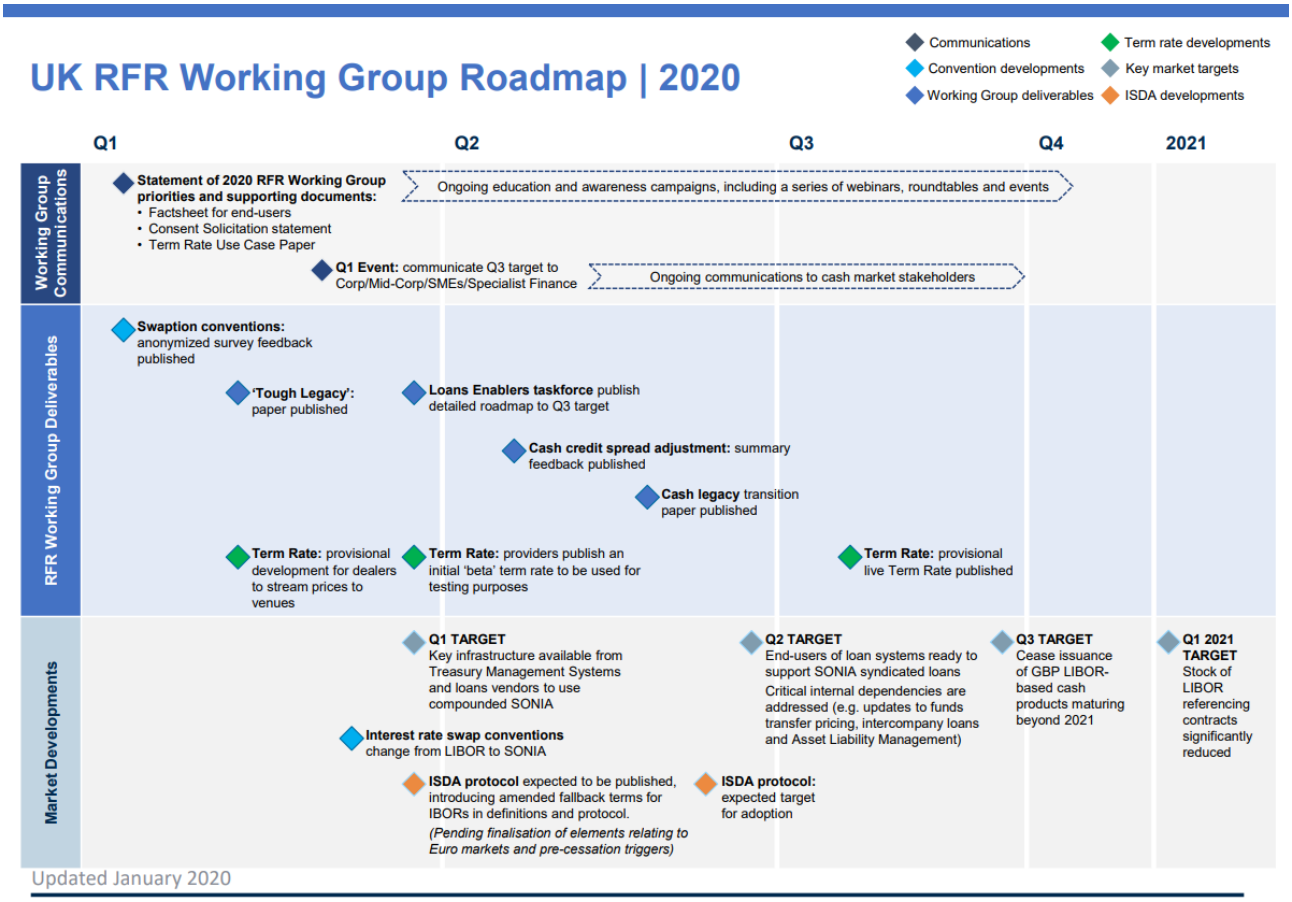
3) [A fact sheet for end users on LIBOR]

This constitutes the first document from the UK RFR WG for end users designed to educate them about the LIBOR transition and the need to take action. It reminds them of what is happening to LIBOR and the milestones of the transition. It contains four call to action for end users: i) Establish where LIBOR exposures are, ii) check contract terms and if they have fallbacks, iii) familiarise yourself with SONIA iv) speak with your bank or product provider.

It will complement a range of material available for stakeholder education, including the UK Finance guide produced in November 2019.

4) An updated roadmap of the LIBOR transition milestones

The RFR WG updated its roadmap of regulatory and industry milestones for the sterling LIBOR transition.



Among the upcoming milestones, the roadmap flags:

- 'beta testing' of GBP LIBOR term rate publication commencing in Q2 2020 with provisional' live term rate' publication expected in Q3 2020.
- the Loans Enablers Task Force, looking at the barriers and efforts required to facilitate the transition in loan markets, to publish a detailed roadmap in early Q2 2020.

- the expected paper on cash legacy transition is now to be published in mid-Q2 2020.
- end-users of loan systems should be ready to support SONIA syndicated loans by the end of Q2 2020.
- The target to cease issuance of GBPLIBOR based cash products maturing beyond 2021 is Q3.

5) A paper on progress of the transition of legacy sterling LIBOR bonds by way of consent solicitation

The paper takes note of the progress achieved in bond markets to transition legacy bonds from LIBOR to SONIA by consent solicitation, a market-based process generally set out in bond documentation which enables an issuer to amend bond conditions by way of bondholder consent.

The paper sets out six considerations for issuers looking to engage in this process, which can be summarised as:

- Assess the suitability of consent solicitation for bonds on a case by case basis;
- Given that it is in the interest of both issuers and investors to move away from LIBOR, so typically there have not been consent fees;
- a pre-announcement solicitation via an RNS announcement may be helpful;
- additional amendments to the conditions of the bond may be considered;
- parties should consider potential market movements between the pricing date and the date on which the amendment is effective; and
- all parties to the consent solicitation (including custodians, agents and trustees, if relevant) should be involved and considering the timing implications.

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We invite you to consider these documents carefully as part of your LIBOR transition plans. We welcome any member feedback or comments on any of the publications issued today and will use our LIBOR Working Group as the central point to discuss these in due course.

A separate note on the on-going RFR WG Credit Spread Adjustment Consultation follows.

Other useful materials for members may be found at UK Finance's microsite on LIBOR, https://www.ukfinance.org.uk/libor-transition. Members simply need to register their email address to access.