UK FINANCE

UK Finance response to Financial Conduct Authority consultation paper CP22/11: Winding down 'synthetic' sterling LIBOR and US dollar LIBOR.

1. **UK Finance is the collective voice for the banking and finance industry. Representing over 300 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.**

2. We welcome the opportunity to respond to this consultation. We summarise our key points on the consultation below and then expand further through the response.

    a) Our membership shares the regulator's view that LIBOR should be wound down as soon as possible. In line with the FCA's guidance, the industry has continued efforts to transition away from synthetic sterling LIBOR and US dollar LIBOR.

    b) However, it remains that there are certain instances where contracts are yet to be transitioned due to various obstacles. Full consideration on the impacts on both customers and the market in these scenarios must be given before a LIBOR tenor is wound down.

    c) In the case of sterling LIBOR, UK Finance members largely agree that the 1- and 6-month sterling LIBOR settings can be ceased at end-March 2023. However, the FCA should be cognisant of the contracts where there remains a risk of a disorderly wind-down and where additional guidance on routes to transition would be of benefit.

    d) UK Finance members believe 3-month sterling LIBOR should be published for at least another year before the situation is then reviewed. The additional year should be used to consider the options available for transition of the contracts that are at risk of being unable to cope with cessation regardless of the time available.

    e) To allow for execution of an appropriate communications strategy with those customers with contracts currently operating on synthetic LIBOR (particularly 3-month synthetic LIBOR in the retail financial services sector), our membership would welcome feedback on the FCA's intention regarding the wind-down of 3-month synthetic LIBOR as soon as possible.

    f) UK Finance cannot agree with the FCA at this stage that it will be possible to transition all remaining exposures to US dollar LIBOR by end-June 2023.

    g) Prevalence of the use of English law offshore of the US, means there are subsequently a large number of US dollar LIBOR contracts not covered by the US federal legislation intended as a solution for legacy contracts that have no workable fallbacks. UK Finance members subsequently believe there are considerable merits in the FCA publishing a synthetic US dollar LIBOR after the end of June 2023.

    h) International coordination continues to be critical, particularly when considering an appropriate methodology for a potential USD synthetic LIBOR rate.

3. Please note that this response may not necessarily reflect the views of all individual UK Finance members but has been written and approved with input from a representative sub-group of the membership.

Answers to Chapter 3 Questions (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?

4. UK Finance members largely agree with the FCA's view that the 1-month sterling LIBOR setting can be ceased in an orderly fashion at end-March 2023.

5. Amongst UK Finance members there remains a small number of loans still linked to the 1-month sterling setting, including some retail mortgages. However, in most instances, the FCA's assumption that these do not represent an unsurmountable issue is agreed with.

6. There does remain a minority of instances where the retirement of synthetic 1-month sterling LIBOR at end-March 2023 may not represent an orderly wind down. For example, some clients will hold loans linked to LIBOR with the contractual right to select different interest periods. If, as proposed, 1- and 6-month sterling LIBOR are retired at end-March 2023, there is an element of uncertainty for these contracts allowing customers to select different tenors. If a lender has been unable to engage the client on active transition, or the client has been unwilling to agree to transition, lenders will then have to consider the best route for the contract. Whilst the continued publication of 3-month synthetic LIBOR remains necessary for at least another year (please see our response to question 3), this will ultimately lead to a phased approach to transition for these contracts. This could lead to the contract being linked to synthetic LIBOR for 3-month interest periods but cost of funds or another fallback rate for the other permitted tenors - an ultimately confusing outcome for customers. A customer having varying rates imposed for different interest periods also creates difficulties for lenders in administering the loan and having to communicate a phased approach to the cessation of sterling LIBOR.

7. Though the need to obtain legal advice to determine the routes available for individual contracts is well understood, any guidance for scenarios where only certain tenors of permitted interest period have their publication ceased, and the impact of this on the fallback process, would be welcomed.

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

8. UK Finance members welcome the reconsideration of the FCA's initial plans of proposing the end of 2022 as the retirement date for 6-month sterling LIBOR. Members agree that in most instances, a cessation date of end-March 2023 for the 6-month sterling LIBOR setting should allow for an orderly wind down.

9. However, some outstanding issues do remain which could potentially risk disruption at end-March 2023 for certain contract types, if not remediated before this. Please see response to Q3b for further detail.

Q3a: 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-month sterling LIBOR exposures in the manner and timeframe we have assumed to be possible?

10. Yes. Whilst UK Finance members perceive the FCA's assumptions on the manner and timeframe possible to transition 1- and 6-month exposures in the vast majority of instances to be correct, there remains reasons as to why some members may not be able to transition their exposures in the timeframe the FCA has assumed possible.

Q3b: 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?

11. These exposures relate to bilateral loans, specifically Private Finance Initiatives (PFIs), referencing 6-month LIBOR.

Q3c: Please explain why these exposures cannot be transitioned in the manner and timeframe we've assumed to be possible, and what alternative timescale you think is needed.

12. UK Finance members welcome the newly proposed timeframe to retire the 6-month synthetic sterling LIBOR setting at end-March 2023. This goes a long way in providing an adequate timeframe to transition PFI contracts onto alternative reference rates, assigning more time for outreach efforts by lenders. However, given the transition of these contracts is dependent on engagement and agreement of the Local Authority in question for each individual contract, there remains a risk that consent to amend the reference rate cannot be obtained in time for the deadline.

13. To date, progress in transitioning PFIs has remained sluggish due to slow Local Authority consent. There has been limited incentive for local authorities to expediate their decisions on giving consent, as it requires Local Authorities to take some fiduciary risk. It is on this basis that there is seen to be an increased risk that some contracts may not be transitioned in the proposed timescale.

14. UK Finance members appreciate the current efforts of both the FCA and the Bank of England in engaging Local Authorities on the matter of LIBOR transition and recognise the rationale that the publication of the consultation may serve as a facilitator for these conversations. Maintaining the increased assertive action from the regulators in encouraging engagement from Local Authorities continues to be a helpful route in mitigating the potential risk around transitioning PFIs.

15. Overall, despite best efforts from lenders, there does still remain some risk of market impact with the retirement of 6-month synthetic sterling LIBOR. However, UK Finance members remain broadly supportive of the retirement date of 30 March 2023.

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

16. The earliest date at which the 3-month sterling LIBOR setting can cease varies considerably across the market depending on the extent of exposure to the setting, as well as the approach taken to transition legacy contracts to date. Some firms have contracts that, despite best efforts, have insurmountable barriers to remediation and subsequently they can only

guarantee that exposure will be lost at the point at which the contract matures. In some of these instances, continuing to publish 3-month synthetic LIBOR for the maximum period permitted by the Benchmarks Regulation, to give the maximum possible time for such contracts to be repaid/refinanced, is seen as beneficial.

17. Subsequently, UK Finance does not believe 3-month LIBOR can cease in an orderly fashion until a resolution has been considered for those contracts which cannot transition away from LIBOR, regardless of the time available. Please see our response to question 6c for further detail.

18. Nonetheless, UK Finance does recognise the merits of ending synthetic sterling LIBOR sooner. Members are supportive of the FCA's desire to see the synthetic tenors retired as soon as possible for an orderly wind down and indeed there are some benefits in 3-month sterling LIBOR ceasing alongside 1- and 6-month at end-March 2023. Paragraph 6 of our response sets out some of the complications of having a phased approach to the retiring of the remaining tenors

19. To help minimise the length of time it is necessary for 3-month sterling LIBOR to continue in order to ensure that its wind down is orderly, there are a number of steps which could be taken. Firstly, UK Finance has welcomed the support from the regulator to date in terms of customer-facing communications. The continuation of these to support lender's efforts to engage customers would be useful.

20. With particular regard to the mortgage market, the continuation of synthetic LIBOR has in some instances been used as a facilitator of active transition, with some firms choosing to benchmark their chosen replacement rate against synthetic LIBOR and using it has a comparator to demonstrate the fairness of their chosen rate. This has subsequently acted as a 'safety net' for some firms, helping them to communicate the merits to active transition to customers and minimise risk. Consideration of the unintended consequences of ceasing publication of synthetic LIBOR in these instances would be beneficial and we would welcome continued willingness by the FCA to engage with our mortgage members on this topic. It would also be helpful if further thought is given to the options described in paragraph 36 in our response to question 6c below.

21. UK Finance also considers the availability of data on market progress to be a facilitator of continued reduction in 3-month sterling LIBOR exposure. This would allow market participants to benchmark their progress against their peers, as well as identify industry wide areas where there is a particular need for increased efforts to be focused. Consideration by the FCA as to how this could be supported would be welcomed.

22. Overall, it is our belief that 3-month sterling LIBOR should be published for at least another year before the situation is then reviewed. The additional year should be used to consider the options available for transition of the contracts discussed in our response to question 6. UK Finance members also maintain their position in response to CP21/22 that, to help support a smooth wind down, the market should receive considerable notice of any intention to cease publication of 3-month sterling LIBOR.

Q5a: Do you – or, if you are a trade body or professional services firm, your members or clients – have exposures 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?

23. Yes. There remain exposures linked to 3-month sterling LIBOR amongst UK Finance members where obstacles have been encountered, or are expected to be encountered, that prevent transition from being completed by end-March 2023.

Q5b: Where the answer is Yes, what asset class(es) and/or types of contract(s) do these obstacles relate to?

24. The asset classes relate to:
    a) Mortgage contracts, both regulated mortgage contracts and Buy-to-Let.
    b) Bonds.
    c) Commercial loans

Q5c: Please provide details of these obstacles, how you intend to overcome them and to what timescale?

Mortgages

25. Some mortgage contracts that reference 3-month Sterling LIBOR contain fallback language that is triggered when LIBOR "ceases" or is no longer "available" (or similar). Until publication of synthetic 3-month Sterling LIBOR ceases, this fallback language is not triggered. This obstacle is overcome by a decision to cease publishing synthetic 3-month sterling LIBOR, which may enable the lender/portfolio holder to operate the fallback provisions in the mortgage contract.

26. Some mortgage contracts do not contain fallback language or a unilateral variation right which would provide a mechanism for the lender to unilaterally replace LIBOR with an alternative interest rate. These may require bilateral agreement between the customer and the lender to amend the mortgage contract. Although lenders may have made repeated attempts to engage with customers in relation to the variation, our members' experience is that some customers may be unwilling to engage (particularly, for example, those customers in arrears or where enforcement action is being taken).

27. Lenders are attempting to overcome these obstacles by (i) adopting a robust communication strategy involving multiple attempts at customer contact via a range of channels; (ii) using all available opportunities to engage with the customer on the topic (for example when a customer contacts the lender about an unrelated matter); and (iii) considering alternative legal mechanisms for transition.

Commercial loans

28. Though we understand it represents a smaller cohort, the same issues around engaging customers as set out for mortgages above applies, particularly for the SME customer segment. However, though this does represent an obstacle, outreach efforts are continuing, and UK Finance members do not see the barriers for this asset class as insurmountable.

Bonds

29. UK Finance members are broadly supportive of the response submitted by the International Capital Markets Association (ICMA), which sets out the obstacles to transitioning bonds in detail.

Q6a: 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?

30. Yes. Please see our response to question 5(c), particularly in regard to residential and buy-to-let mortgage contracts. These are often long-dated with maturity dates beyond the maximum 10 year life span of synthetic LIBOR.

Q6b: Where the answer is Yes:

- **a) What type of contract(s) are they?**
- **b) Which LIBOR setting do they reference?**
- **c) How many contracts are there?**
- **d) What is their approximate total value?**
- **e) When are they due to mature?**

31. UK Finance will provide aggregated data relating to the residential mortgage exposures to synthetic sterling LIBOR we have sight of.

Q6c: 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?

32. As the FCA has identified in its earlier consultations on LIBOR transition, across the mortgage market in particular, there are some mortgage contracts which the lender or portfolio-holder has assessed may require customer consent to replace LIBOR with an alternative reference rate.

33. If these mortgage contracts are not repaid (for example they reach the end of the term, are repaid early or the customer switches to another product/remortgages) before synthetic 3-month sterling LIBOR ceases and customer consent cannot be obtained, a lender/portfolio holder may be unable to transition the contract to an alternative rate using a mechanism for transition that is within its legal risk appetite. There are various possible analyses of the effect of this on the mortgage contract when 3-month sterling LIBOR ceases, but there is a risk that the result is that the mortgage contract no longer performs as the customer would expect.

34. UK Finance members believe that it is important that consideration is given at an early stage to what should happen to those contracts that may still be unable to actively transition during the life of 3-month synthetic sterling LIBOR. This could include:

    a) Continuing to publish 3-month synthetic LIBOR for the maximum period permitted by the Benchmarks Regulation, to give the maximum possible time for such contracts to be repaid/refinanced;

b) exploring a legislative solution for contracts that have been unable to transition when synthetic 3-month sterling LIBOR ceases, to provide a fallback to an alternative rate (in a similar way to the legislative fallback to synthetic LIBOR);

c) or actively support alternative mechanisms to transition which assists lenders to bring such mechanisms within their accepted legal risk appetite.

Answers to Chapter 4 Questions (USD LIBOR):

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

35. Though the extension to the deadline for USD LIBOR has been useful in allowing the market more time for efforts to transition, there may remain a minority of contracts which face barriers to transitioning to alternative rates by end-June 2023.

36. Therefore, overall UK Finance cannot agree with the FCA at this stage that it will be possible to transition all remaining exposures to US dollar LIBOR in line with the FCA's assumptions.

Q8a: 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?

37. Yes. There remain exposures to USD LIBOR amongst UK Finance members where obstacles have been encountered, or are expected to be encountered, that prevent transition from being completed by end-June 2023.

Q8b: Where the answer is Yes, what asset class(es) and/or types of contract(s) do these obstacles relate to?

38. Our current assumptions of the asset classes/types of contracts which may face obstacles are:

    a) USD bonds under English Law.

    b) Commercial Loans - syndicated loans and potentially bilateral loans with market participants/customers in markets less familiar with LIBOR transition (emerging markets). Project finance arrangements including multiple stakeholders.

    c) Derivatives - where it has not been possible to sign the ISDA protocol and which are hedging USD bonds.

Q8c: Please provide details of these obstacles, how you intend to overcome them and to what timescale?

39. Please see below details of the obstacles some UK Finance members are encountering, or expect to encounter, for the asset classes/types of contracts set out in answer to question 8b:

a) **USD bonds under English Law** - UK Finance members are broadly supportive of the response submitted by ICMA, which sets out the obstacles to transitioning USD bonds by end-June 2023 in detail.

b) **Commercial loans** – This specifically relates to syndicated and bilateral loans with participants/counterparties in markets less familiar with LIBOR transition, such as in emerging markets. Lenders are continuing efforts to engage all counterparties in pursuit of active transition, however the challenges of doing so should not be underestimated. This particularly applies to parties in jurisdictions the merits, necessity and timeline of LIBOR transition have been less propounded by the relevant authorities. UK Finance emphasises the importance of the FCA continuing to liaise with regulatory authorities in other jurisdictions and in particular, encouraging the publication of local regulatory guidelines or communications on clear expectations for transition efforts.

Additionally, project finance arrangements with multiple stakeholders are likely to have protracted timelines for securing consent. This is not necessarily due to the stakeholders involved being less sophisticated or having a lower understanding of the implications of LIBOR transition. The process will remain drawn out due to the number of parties having to engage and consent to a new arrangement.

c) **Derivatives** – For example, where it has not been possible to sign the ISDA protocol and where the derivative is used to hedge a US dollar bond. Where the transaction was executed prior to July 2017, the derivatives may not contain any fallback language. To overcome this obstacle, the issuer under the transaction may be asked to initiate a consent solicitation process ahead of June 2023 with the aim of transitioning such derivatives away from USD LIBOR with Noteholder consent.

However, such an exercise would require transaction counterparties to come to an agreement upfront on the transition approach (and the costs of paying for it), which may be difficult given that precedents for the transition of the Notes and derivatives differ, and that the transition may not result in value neutrality. Accordingly, there is a material risk that consent will not be obtained, which may create hedge accounting issues, a potential downgrade of the rated Notes by the rating agencies and exchange rate currency risk for all secured creditors in the transaction.

Q8d: 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.

40. We do not intend to respond to this question. Should UK Finance members have relevant examples they will submit these to the FCA on an individual basis.

Q9a: 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 time available – because they do not have workable fallbacks, cannot be transitioned away, and cannot cease before maturity without causing disruption?

Q9b: Where the answer is Yes:

- **a) What type of contract(s) are they?**
- **b) Which LIBOR setting do they reference?**
- **c) How many contracts are there?**
- **d) What is their approximate total value?**
- **e) When are they due to mature?**
- **f) What is the relevant governing law?**

Q9c: 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 US dollar LIBOR setting ceased?

41. Please see our answer to question 8c regarding the contracts which may face challenges should customer consent not be achieved, as well as our support of ICMA's response relative to the obstacles faced by contracts in the bond market. If transition attempts are unsuccessful in these instances, if LIBOR were to cease before contract maturity it would cause considerable disruption.

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

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

42. UK Finance members strongly agree with the FCA's recognition of the global nature of US dollar LIBOR. The widespread use of US dollar LIBOR has meant a significant volume of the remaining exposure lies outside of the domestic US market in a wide range of jurisdictions, including emerging markets. Prevalence of the use of English law offshore of the US, means there are subsequently a large number of US dollar LIBOR contracts not covered by the US federal legislation intended as a solution for legacy contracts that have no workable fallbacks. The publication of a synthetic dollar LIBOR would subsequently have a positive impact in providing a temporary off-ramp for those contracts under English law set out in question 8c.

43. These contracts would also benefit from the provisions set out in the Critical Benchmarks (References and Administrators' Liability) Act 2021, serving to promote the smooth wind down of LIBOR and avoid preventable disruption by providing legal certainty as to how contractual references to a critical benchmark should be treated in the event the FCA exercises its powers under the Benchmarks Regulation (BMR).[1]

44. UK Finance members recognise that the publication of a synthetic US dollar LIBOR rate could have unintended adverse consequences if not properly considered. However, there are mitigating actions that can be taken to minimise the potential likelihood or impact of these consequences:

    a) Inadvertently hindering progress for contracts which require customer or other lender engagement – as seen with sterling LIBOR, this can be mitigated by appropriate FCA customer-facing communications and clear regulatory guidance on the expectations

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[1] https://www.legislation.gov.uk/ukpga/2021/33/contents/enacted

of firms beyond 2022. In the case of sterling LIBOR, the FCA has successfully made clear that any introduction of synthetic rates is a last resort off-ramp only and not a substitute for active transition. The continued transition of contracts away from synthetic LIBOR in the sterling market has been a good example of the success of this.

b) Possible divergence of outcome across the market – There poses a risk of divergence of outcome across the market if the methodology used for synthetic USD LIBOR does not reflect that of the replacement rates for those contracts under the US legislation. UK Finance members emphasise the benefits of continuing the FCA's efforts to date in promoting alignment where appropriate and beneficial between jurisdictions.

c) Impact on contracts without pre-cessation triggers – UK Finance members welcome the recent publication by the Alternative Reference Rates Committee (ARRC) of the LIBOR legacy playbook.[2] The playbook sets out the anticipated status of different broad categories of USD LIBOR contracts after 30 June 2023, highlighting that those contracts without pre-cessation triggers, both under US and foreign law, may have their transition trajectory impacted by the publication of synthetic LIBOR. For example, those contracts which do have a hardwired replacement rate, but which do not include a pre-cessation trigger, would be likely to move onto synthetic US dollar LIBOR in the first instance, before then switching to the replacement rate at the point this ceases in the future. Therefore, UK Finance members emphasise the importance that any synthetic LIBOR methodology aligns with the federal reserve promulgations in autumn, to ensure there is no subsequent value transfer at the point at which synthetic US dollar LIBOR retires.

   However, we also note and welcome the Federal Reserve's publication on 19 July of a proposal on implementation of the Adjustable Interest Rate (LIBOR) Act.[3] This includes consideration of where the Federal Reserve may be able to use the Act to support the transition of those LIBOR contracts under US Law which would not be triggered expressly when LIBOR is available but nonrepresentative, were a synthetic LIBOR rate to be published. This would be intended to prevent the unintended consequence of their route to transition being undermined by the publication of a synthetic LIBOR rate.

45. Overall, UK Finance members believe there is a need for the FCA to publish a synthetic US dollar LIBOR after the end of June 2023 for certain contracts to avoid causing disruption where transition has not been possible and there are no workable fallbacks. UK Finance members like to highlight the importance of having further opportunities to engage with the process for decisions regarding a potential USD synthetic LIBOR and its permitted use. Our members would welcome clarification by the FCA as to whether this would mirror the process seen for sterling.

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[2] https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2022/LIBOR_Legacy_Playbook.pdf

[3] https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20220719a1.pdf