

MEMO# 33919

November 23, 2021

LIBOR Update: UK Financial Conduct Authority Issues Confirmation of Rules for Use of Synthetic LIBOR; Financial Stability Board Urges Preparation for LIBOR Cessation

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TO: ICI Global Members

LIBOR Transition Working Group SUBJECTS: Derivatives

Financial Stability RE: LIBOR Update: UK Financial Conduct Authority Issues Confirmation of Rules for Use of Synthetic LIBOR; Financial Stability Board Urges Preparation for LIBOR Cessation

Global regulators and policymakers continue to address LIBOR transition by market participants. Below, we discuss two recent developments: a UK Financial Conduct Authority (FCA) confirmation of its policy on the use synthetic versions of UK sterling and Japanese yen LIBOR when those rates become unrepresentative at the end of 2021 and a Financial Stability Board (FSB) statement encouraging market participants to actively prepare for LIBOR cessation.

Financial Conduct Authority Confirmation of Rules for Legacy Use of Synthetic Rates

On November 16, the FCA issued several documents confirming the temporary use of synthetic UK sterling and Japanese yen LIBOR rates by UK-supervised entities in legacy contracts.

First, the FCA published a draft notice setting out its decision to require the continued publication of certain sterling and yen rates under synthetic methodology and permitting legacy use (other than in cleared derivatives) of these synthetic rates by UK-supervised entities.[\[1\]](#) These requirements are largely consistent with the FCA's recent consultation on the use of synthetic rates in legacy contracts.[\[2\]](#) The FCA also provided a feedback statement that summarized the responses that the FCA received from that recent consultation.[\[3\]](#) The FCA stated that, in general, respondents to the consultation supported

the legacy use of synthetic LIBOR. Notably, several respondents recommended international consistency between the UK approach and that of other jurisdictions, and some respondents commented on the need for legal certainty on the continuity of legacy contracts.

In addition to the above policy confirmation, the FCA issued a notice^[4] prohibiting UK-supervised entities from new use of US dollar LIBOR rates after December 31, 2021, although most of those rates will not cease until June 30, 2023.^[5] The notice provides exceptions to the prohibitions, including for market making, hedging, novations, central counterparty auction procedures, and interpolation (or other use provided for in contractual fallback arrangements in connection with US dollar LIBOR rates that will cease on December 31, 2021), under designated circumstances. The notice also includes an annex clarifying that (1) the market-making exception applies only if that activity is requested by a client seeking to hedge or reduce US dollar LIBOR exposure; and (2) the prohibition on new use of US dollar LIBOR does not prohibit single currency basis swaps entered into in the interdealer broker market.

Financial Stability Board Statement

On November 19, the FSB issued a statement reminding market participants that most LIBOR rates will cease at the end of 2021 and that continued reliance on LIBOR poses risks to financial stability.^[6] The FSB notes that although US dollar LIBOR is expected to continue through June 30, 2023, that continuation is only intended to support the maturity of legacy contracts and should not be used for new financial instruments or contracts.

The FSB also encourages market participants to use overnight risk-free rates as alternatives to LIBOR as it considers those rates the most robust. It recognizes, however, that term rates, such as forward-looking term SOFR, can have a role in the marketplace that is compatible with financial stability.

To best prepare for LIBOR transition, the FSB recommends that market participants actively transition legacy contracts to another rate and warns that synthetic versions of rates, such as the synthetic sterling and yen LIBORs permitted by the FCA, are only temporary bridging solutions.

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endnotes

^[1] Article 23C Benchmarks Regulation - Notice of Permitted Legacy Use by Supervised Entities, *available at* <https://www.fca.org.uk/publication/libor-notices/article-23c-benchmarks-regulation-draft-permitted-legacy-notice.pdf>.

^[2] See LIBOR Update: FCA Issues Notices and Consultation on Tough Legacy and Synthetic LIBOR, ICI Memorandum No. 33797 (October 1, 2021), *available at* <https://www.ici.org/memo33797>. See also Investment Company Institute response to the Financial Conduct Authority consultation on the proposed decisions on the use of LIBOR

(October 20, 2021), available at <https://www.ici.org/system/files/2021-10/33837a.pdf>.

[3] Feedback Statement: Article 23D of the Benchmarks Regulation Decision for 6 Sterling and Yen LIBOR Versions FS21/11 (November 12, 2021), available at <https://www.fca.org.uk/publication/feedback/fs21-11.pdf>.

[4] Article 21 Benchmarks Regulation - Notice of Prohibition on New Use of a Critical Benchmark, available at <https://www.fca.org.uk/publication/libor-notices/article-21a-benchmarks-regulation-prohibition-notice.pdf>.

[5] 1-week and 2-month US dollar LIBOR will cease December 31, 2021.

[6] See FSB Statement to Support Preparations for LIBOR Cessation (November 19, 2021), available at <https://www.fsb.org/wp-content/uploads/P211121.pdf>.

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