ICMA

20 December 2022

ICMA RESPONSE TO FCA CONSULTATION PAPER CP22/21 ON 'SYNTHETIC' US DOLLAR LIBOR[1]

Key points

1. ICMA welcomes the FCA's proposal to require the publication of the 1-, 3- and 6-month synthetic US dollar LIBOR settings from 30 June 2023, which is essential for legacy US dollar LIBOR bonds outstanding when panel bank LIBOR ceases.

2. ICMA agrees that the methodology for synthetic US dollar LIBOR needs to result in a rate that aligns with the rate that will be applied under the US LIBOR Act, which is expected to be the case. In line with the approach for synthetic sterling LIBOR, the market is also expecting synthetic LIBOR to appear as a single value incorporating both the term SOFR and ISDA fixed spread adjustment elements on the same screens (including commercial providers' screens) as panel bank LIBOR.

3. The proposal to permit use of synthetic US dollar LIBOR In all legacy LIBOR bonds, not just some of them, is welcome because it will avoid significant legal and practical uncertainty that could otherwise arise in the bond markets.

4. ICMA appreciates that setting a realistic target date for cessation of synthetic US dollar LIBOR should encourage active transition, in cases in which active transition is feasible. But any unconditional commitment to cessation on 30 September 2024 at this stage would run unnecessary risks:

   a. There are more US dollar LIBOR bonds to transition than sterling LIBOR bonds, and they are expected to be more complex to transition. US dollar LIBOR bonds have been issued on a global basis and are held by different types of investors (including retail investors) located around the world, some of whom may have limited, or even no, awareness of LIBOR transition.

   b. End-September 2024 is roughly 21 months away. This is a relatively short period of time to transition the high number of relevant legacy US dollar LIBOR bonds[2] compared with the 27 months that is helpfully being provided to transition the smaller number of outstanding legacy bonds referencing 3-month sterling LIBOR[3].

   c. US dollar LIBOR bonds governed by a law of the US and subject to the US LIBOR Act will continue to reference a floating rate until their maturity. An FCA deadline to cease publication of synthetic US dollar LIBOR on 30 September 2024 for financial instruments governed by English and other non-US laws would end alignment with bonds governed by

[1] https://www.fca.org.uk/publication/consultation/cp22-21.pdf
[2] Namely non-US law governed, US dollar LIBOR bonds with Type 1 fallbacks. See footnote 4 below for a description of Type 1 fallbacks.
[3] Publication of 3-month synthetic sterling LIBOR commenced at the start of January 2022 and will continue until end-March 2024 (ie a period of 27 months).

a law of the US, because bonds that are not feasible to transition and have Type 1 fallbacks[4] would fall back to a fixed rate (ie the opposite of the original intention and the opposite of the approach under the US LIBOR Act). This loss of alignment risks causing confusion in the bond markets and would potentially threaten market integrity. As acknowledged by the FCA[5], it is important that international consistency is maintained to avoid market fragmentation or unwanted basis risk, where practicable.

d. Given the FCA is required to review its decision to compel IBA to publish synthetic LIBOR at least annually, it would be prudent to avoid any unconditional commitment to an end-September 2024 cessation date at this stage and instead analyse during the annual review whether to take the risk of cessation at the end-September 2024 or to postpone the cessation date.

Introduction

5. ICMA welcomes the opportunity to respond to the FCA's consultation on 'synthetic' US dollar LIBOR. This ICMA response has been prepared from the perspective of the international bond markets, with a particular focus on bonds governed by English law. ICMA has over 600 members in 65 jurisdictions globally including across Europe and Asia Pacific.

6. This ICMA response has been informed by data provided by Bloomberg. Following prior approval from Bloomberg, ICMA has shared this information with the FCA on a confidential basis. ICMA does not have permission to share this data publicly.

Q1: Do you have any views or comments regarding our proposal on a synthetic US dollar LIBOR and its duration – or any other comments on this section of this consultation?

7. ICMA welcomes the FCA's proposal to require the publication of the 1-, 3- and 6-month synthetic US dollar LIBOR settings from 30 June 2023, which is essential for legacy US dollar LIBOR bonds outstanding when panel bank LIBOR ceases[6].

8. However, the proposed duration of synthetic US dollar LIBOR will require review. Any unconditional commitment to cessation on 30 September 2024 at this stage would run unnecessary risks, as detailed in paragraph 4a - d of the "Key points" section above.

9. The FCA indicates in paragraph 3.9 of the Consultation Paper that an end-September 2024 cessation date "should allow the majority of the population of non-US law governed legacy contracts to transition away or reach maturity, and therefore secure an orderly transition". However, the transition of *the majority* of legacy LIOR bonds before end-September 2024 would not secure an orderly transition in the bond markets if the remainder cannot be transitioned and fall back from a floating rate to a fixed rate, leading to the consequences set out in paragraph 4c of the "Key points" section above.

10. We recommend that the FCA monitors progress (including by reference to relevant data) in active transition away from synthetic US dollar LIBOR during 2023 and reviews its proposed cessation

[4] Type 1 fallbacks are traditional bond fallbacks triggered when the reference rate does not appear on the relevant screen page or the relevant screen page is unavailable. They are expected to result in floating rate notes becoming fixed rate notes in the event of LIBOR cessation. For a brief description of Type 1, Type 2 and Type 3 fallbacks, see paragraph 4 starting on page 4 of ICMA's response to FCA CP 21/15. These broad categories do not describe every case and the precise language used in fallbacks can vary from bond to bond.
[5] Paragraph 3.41 of FCA Consultation Paper CP22/21.
[6] See ICMA response to FCA Consultation Paper CP22/11.

date as part of its annual review of the exercise of its powers under the UK Benchmarks Regulation.

Q2: Do you agree with the manner in which we propose to exercise our methodology change power?

11. Yes, we agree that synthetic US dollar LIBOR should be calculated as the sum of the CME Term SOFR Reference Rate plus the ISDA fixed spread adjustment for the corresponding settings. This approach would be consistent with the outcome that is expected to be used under the US LIBOR Act. It is helpful that the FCA acknowledges the importance of maintaining international consistency to avoid market fragmentation or unwanted basis risk in paragraph 3.41 of the Consultation Paper.

Q3: Do you have any other views or comments on our proposed exercise of our methodology change power, including about how this would impact you?

12. It is helpful that the FCA has confirmed in paragraph 3.46 of the Consultation Paper that each of the US dollar settings will continue to be published at or around 11.55am London time on each applicable London business day.

13. In line with the approach for synthetic sterling LIBOR, the market is also expecting synthetic US dollar LIBOR to appear as a single value incorporating both the term SOFR and ISDA fixed spread adjustment elements on the same screens (including commercial providers' screens) as panel bank LIBOR.

Q4: Do you agree with the manner in which we propose to exercise our legacy use power?

14. We agree that legacy use of synthetic US dollar LIBOR should be permitted in all legacy bonds, in line with the approach that was taken for synthetic sterling and yen LIBOR. This will avoid significant legal and practical uncertainty arising in the legacy LIBOR bond market.

15. For the reasons explained in ICMA's response to the FCA's consultation on use of critical benchmarks of May 2021, a broad permission to use synthetic LIBOR for legacy bonds is important to avoid significant legal and practical uncertainty that could otherwise arise and pose a threat to market integrity and consumer protection. Briefly, this includes uncertainty as to whether bond fallbacks have been triggered or not, events of default being triggered and mandatory redemption of legacy securitisations at par; all of which may be disputed based on, among other things, the precise wording of bond provisions and different possible interpretations of the scope of "use" under the BMR. The FCA's proposed approach of allowing OTC derivatives to reference synthetic rate US dollar LIBOR is also important to allow hedging agreements to continue to operate, which is particularly important for structured transactions.

Q5: Do you have any other views or comments on our proposed exercise of our legacy use power, including about how this would impact you?

16. No.