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Dear SMF

<u>Next steps on LIBOR transition</u>

In June 2019, the Financial Conduct Authority (the FCA) and the Bank of England (the Bank) provided individual feedback to major firms who received our 2018/19 Dear CEO letter on LIBOR transition. We also published a feedback statement highlighting the importance of firms appropriately identifying and quantifying LIBOR exposures, and having detailed and robust plans in place to transition to alternative Risk-Free Rates (RFRs). The statement also encouraged firms to seek opportunities to transact using RFRs, and to support industry initiatives to ensure a smooth transition from LIBOR.

The FCA and the Bank will continue to support market-led transition efforts through the Working Group on Sterling Risk Free Reference Rates (RFRWG), including by working with the RFRWG, the Official Sector Steering Group, and each acting unilaterally to remove barriers to transition. For example, in November 2019 the FCA published Q&As to support firms in managing the conduct implications of transition; and on 18 December 2019 Sam Woods set out, in his letter to Tushar Morzaria, RFRWG Chair, how the Prudential Regulation Authority (PRA) is considering the interactions between LIBOR transition and the prudential regulatory framework.

In that context, the Financial Policy Committee (the FPC) has considered further potential supervisory tools that authorities could use to encourage the reduction in the stock of legacy LIBOR contracts to an absolute minimum before end-2021. The FPC will keep the potential use of supervisory tools under review in light of transition progress made by firms. As they have made clear, **'The intention is that sterling LIBOR will cease to exist after the end of 2021. No firm should plan otherwise.'**

This update from the FCA and the PRA sets out our initial expectations for transition progress during 2020.

Although several important milestones were met last year, as highlighted in the appendix, greater momentum is needed, and **2020 will be a key year for transition.** Orderly and timely progress requires individual firms to actively engage with the wider transition efforts in the market – both those of the authorities and of industry. We expect to see clear evidence of this engagement from the beginning of Q1 2020.

The RFRWG has set a series of **targets for 2020**, including to:

- Enable a further shift of volumes from LIBOR to SONIA in derivative markets, supported by a statement from the Bank and FCA encouraging a switch in the convention for sterling interest rate swaps from 2 March 2020;
- Cease issuance of sterling Libor-based cash products maturing beyond 2021 by end-Q3 2020;[1] and
- Significantly reduce the stock of LIBOR referencing contracts by Q1 2021.

The FCA and the Bank support these targets. They have also been endorsed by the Risk-Free Rate Senior Advisory Group, and are set out in the public transition road map. We expect all firms to play their part in meeting these targets: LIBOR transition plans should include the targets in project milestones and ensure that management information is available to track progress. As a guide, we consider that action in the following areas is key to delivery, and should feature in firms' planning from Q1:

- product development;
- reviewing infrastructure, including updating loan system capabilities;
- client communications and awareness; and
- updating documentation.

Ongoing engagement

The FCA and the PRA will step up engagement with firms on LIBOR transition through our regular supervisory relationship, reviewing your management information and by collecting data from you to assess progress. The first set of management information and data, requested from dual-regulated firms at the end of September, was due by 31 December. We will discuss the information firms have provided, and their progress with transition – including how their plans reflect the RFRWG targets. Progress in these areas, along with those identified in the June 2019 'Dear CEO' feedback statement, will help demonstrate that firms are taking due account of the expected demise of LIBOR at end-2021. It will also be a key input to the FPC's consideration in mid-2020 of whether sufficient progress is being made to avoid seeking recourse to supervisory tools.

The months ahead will be critical in achieving a successful and smooth transition from LIBOR by end-2021. We welcome firms' continued cooperation on this topic.

Yours sincerely,

David Bailey   Sarah Breeden   Anna Sweeney   Megan Butler   Jonathan Davidson

[1] Updated 22 Jan 2020: to clarify that this RFRWG target relates to products maturing beyond 2021 (see RFRWG 2020 priorities and roadmap at https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/rfr/rfrwgs-2020-priorities-and-milestones.pdf?la=en&hash=653C6892CC68DAC968228AC677114FC37B7535EE)

Appendix – progress made in 2019

Sterling LIBOR

Over the last 6 months, SONIA Overnight Index Swaps accounted for around 50% of cleared swaps by notional traded value, and since 2018 there have been over 85 SONIA bond issuances totalling over £40 billion. Three SONIA linked loans have been completed, and the first conversion of a LIBOR linked loan to SONIA was announced in October. The International Swaps and Derivatives Association (ISDA) has also made significant progress in developing robust fall-backs for derivative contracts, and in securing market consensus on a fair replacement value for LIBOR.

SONIA liquidity

Liquid markets for SONIA in cash and derivatives are important building blocks for a decisive shift away from LIBOR. Despite this, significant volumes of sterling LIBOR swaps contracts continue to be written, and hence the stock of LIBOR-referencing contracts continues to grow. This includes contracts that mature beyond the end of 2021. With that in mind, the Financial Policy Summary and Records of the FPC Meetings on 11 July and 2 October 2019 set out that 'There is no justification for firms continuing to increase their exposures to LIBOR'. Firms will need to manage down this stock of LIBOR linked contracts, and ensure that robust fall-backs are included wherever possible, to avoid significant legal uncertainty after 2021. Additionally, the pace of transition in the loan market will need to speed up during 2020 if these products are to be widely available and in use before the end of 2021.

SOFR liquidity

Looking beyond sterling, liquidity in SOFR continues to build, with around US$7 trillion of notional issuance in cash and derivatives products since April 2018. However, greater momentum is also needed here to ensure timely and orderly transition by end 2021.

Supervisory Approach

After the Dear CEO letter feedback statement was published in June 2019, the PRA and FCA increased the level of engagement with firms on LIBOR transition. Individual firms are transitioning away from LIBOR at different rates, and we continue to expect all firms to be proactive in taking early action to mitigate the risks from transition.