The Working Group on
Sterling Risk-Free Reference Rates

Path to ending new use of GBP LIBOR-linked derivatives

The Working Group on Sterling Risk-Free Reference Rates (the 'Working Group')[1] has published an update to its priorities and roadmap for the final year of transition. For the GBP LIBOR-linked derivatives market the recommended milestones established by the Working Group are:

- By end-Q1 2021, cease initiation of new GBP LIBOR-linked linear derivatives* that expire after the end of 2021.
- By end-Q2 2021, cease initiation of new GBP LIBOR-linked non-linear derivatives* that expire after the end of 2021.
- During Q2/Q3 2021, cease initiation of new cross-currency derivatives with a LIBOR-linked sterling leg*, that expire after the end of 2021.
- Progress active conversion of all legacy GBP LIBOR contracts where viable through to completion by end-Q3 2021.

  * Except for risk management of existing positions.

As set out in their recent joint press release with the Working Group, the Bank of England and the FCA continue to work closely with firms to support a smooth transition. In particular, supervisors of regulated firms have said they will continue to expect transition plans to be executed in line with the recommended timelines. Senior managers with responsibility for the transition should expect close supervisory engagement on how they are ensuring their firm's progress relative to the recommended timelines.

The Working Group's key expectation for all market participants is that any new GBP derivatives that expire after the end of 2021, entered into after the recommended milestones, be based on SONIA. To support this and building on the 'SONIA first' initiative in October 2020, the Working Group proposes in particular that interdealer broker trades taking place after the relevant milestone solely reference SONIA[2], with the exception of single currency basis swaps to facilitate transition flows.

The Working Group recognises that there will be limited circumstances when it may be appropriate to enter into new GBP LIBOR-linked derivative contracts that expire after the end of 2021, after the relevant milestone, for risk management of existing positions or exposure resulting from existing contracts, and to support active conversion. These are:

(i) transactions that reduce or hedge the firm's, or any client of the firm's, GBP LIBOR exposure on contracts;
(ii) market making in support of client activity related to existing GBP LIBOR contracts[3], including streaming of prices to support such activity and to support other benchmarks;
(iii) novations of GBP LIBOR transactions;
(iv) transactions executed for purposes of required participation in a central counterparty auction procedure in the case of a member default, including transactions to hedge the resulting GBP LIBOR exposure;

and

(v) transactions in GBP LIBOR-linked exchange traded futures and options executed before end-Q2 2021, or otherwise in line with the relevant exceptions set out above.

The intention is for continued use of GBP LIBOR via risk management exceptions to be kept to a prudent minimum. Best practice for making use of these exceptions would likely include firms establishing clear internal governance and oversight, given the potential increased risks with managing these positions past the end of 2021.

Furthermore, to progress transition in the non-linear derivatives market and the exchange traded derivatives market, and support market participants in meeting the recommended milestones as soon as possible, the Working Group intends to work with the FCA to explore the potential to change market standard trading conventions to a SONIA basis in both of these markets at an appropriate point during Q2 2021.

Notes

[1] The Bank of England and the Financial Conduct Authority (the "FCA") are each ex-officio members of the Working Group. The views and outputs set out in this document do not constitute guidance or legal advice from the Bank of England (including the Prudential Regulation Authority (the "PRA") or the FCA and are not necessarily endorsed by the Bank of England (including the PRA) or the FCA. This document is not intended to impose any legal or regulatory obligations on market participants. It does not constitute a comprehensive outline of all relevant considerations and is not a substitute for market participants' own research and professional advice.

[2] As per exception (ii), the Working Group recognises that firms may need to continue to stream GBP LIBOR prices to interdealer broker MTFs to support other benchmarks.

[3] The Working Group recognises that dealers and other market makers executing such trades for their clients may accumulate LIBOR risk as a result and that they cannot necessarily assess, or reasonably be expected to seek to discover, the intent of their clients when approached to initiate a LIBOR derivative trade. The Working Group considers that firms should, however, make reasonable efforts to ensure clients are aware of the guidance and to engage with them on the extent to which they have taken the guidance into account.