Consultation on successor rate to GBP LIBOR in legacy bonds referencing GBP LIBOR – Summary of Responses

The Working Group on Sterling Risk-Free Reference Rates

March 2021

Consultation on successor rate to GBP LIBOR in legacy bonds referencing GBP LIBOR – Summary of Responses[1]

The Working Group on Sterling Risk-Free Reference Rates ("the Working Group") issued a consultation seeking the views of bond market participants on whether it would be helpful for the Working Group to make a recommendation on a successor rate to GBP LIBOR for bonds upon the occurrence of a permanent cessation event or a pre-cessation event, and to seek feedback on the successor rate to be recommended.

The consultation was open from 2 February 2021 until 16 March 2021 and attracted 24 responses from a range of market participants (see Chart 1). Respondents included banks and non-bank financial institutions such as investment /asset managers and trade associations.

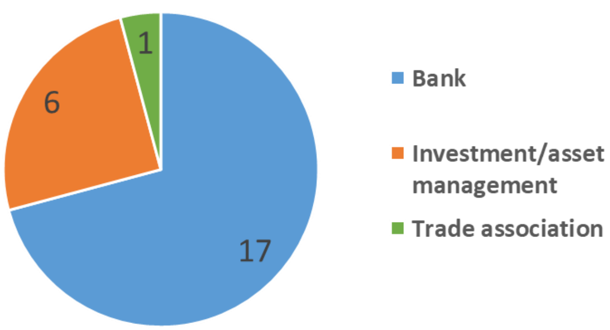
Respondents answered questions on: whether the Working Group should make a recommendation on the successor rate to GBP LIBOR for the purposes of the operations of 'Type 2' and 'Type 3' bond fallbacks; whether the recommended successor rate should be overnight SONIA compounded in arrears, term SONIA, or any other SONIA based methodology; and whether details regarding further conventions to be used to accompany the successor rate should be left to the issuer to agree on.

This paper summarises the responses received. The Working Group will discuss these results at its forthcoming meetings, including consideration of potential next steps to help catalyse further transition in sterling bond markets based on this feedback.

Key takeaways:

- **All 24 respondents to the consultation considered that it would be helpful for the Working Group, in its capacity as a relevant nominating body, to make a recommendation on the successor rate to GBP LIBOR for the purposes of the operation of 'Type 2' and 'Type 3' fallbacks in bond documentation.**
- **The consultation identified a large majority (22 out of 24 respondents) in favour of the selection of overnight SONIA, compounded in arrears (Option 1) as the recommended successor rate to GBP LIBOR for Type 2 and Type 3 fallbacks.**
- **A small minority (2 out of 24 respondents) considered that overnight SONIA, compounded in arrears, should not be the recommended successor rate. These respondents considered that a form of term SONIA (Option 2) should be recommended.**
- **A majority (17 out of 24 respondents) considered that details regarding further conventions to be used to accompany the successor rate, such as use of observation lag or shift, should be left to the issuer to agree on a case by case basis.**

Chart 1: Distribution of respondents



[1] This Summary of Responses is prepared by the Bank of England and the Financial Conduct Authority ("FCA") as the Secretariat of the Working Group on Sterling Risk-Free Reference Rates. The Bank of England and the FCA are each ex-officio members of the Working Group. The views and outputs set out in this Summary do not constitute guidance or legal advice from the Bank of England (including the Prudential Regulation Authority ("PRA")) or the FCA and are not necessarily endorsed by the Bank of England (including the PRA) or the FCA.

Summary of Responses

Question 1: *Do you consider that it would be helpful for the Working Group, in its capacity as a relevant nominating body, to make a recommendation on the successor rate to GBP LIBOR for the purposes of the operation of:*

(i) Type 2 fallbacks in bond documentation, where the relevant fallback triggers are intended to operate upon the occurrence of a permanent cessation event, and

(ii) Type 3 fallbacks in bond documentation, where the relevant fallback triggers are intended to operate upon the occurrence of a pre-cessation event?

- **All respondents (24 out of 24)** answered yes to Question 1, that it would be helpful for the Working Group, in its capacity as relevant nominating body, to make a recommendation on the successor rate to GBP LIBOR for the operation of both: i) Type 2 fallbacks in bond documentation, where the relevant fallback triggers are intended to operate upon the occurrence of a permanent cessation event; and; ii) Type 3 fallbacks in bond documentation, where the relevant fallback triggers are intended to operate upon the occurrence of a pre-cessation event.
    - Half of respondents provided additional reasoning for their positive answer. Where a reason was given, the most common reason stated was that a recommendation would bring certainty to the market.
    - Four respondents noted that whilst they considered a recommendation would be helpful, they would prefer that market participants retain the freedom to deviate from the recommendation where they considered this to be appropriate in individual cases.

Question 2: *Do you consider that the recommended successor rate to GBP LIBOR for Type 2 fallbacks and Type 3 fallbacks should be overnight SONIA, compounded in arrears (Option 1)?*

- **A large majority (22 out of 24 respondents)** answered yes to Question 2, that they considered the recommended successor rate to GBP LIBOR for Type 2 fallbacks and Type 3 fallbacks should be overnight SONIA, compounded in arrears (Option 1).
    - Where a reason for answering yes was given, the most commonly stated reason was alignment with existing market conventions, particularly in the SONIA-linked floating rate note market and the derivatives markets.
    - One respondent, who answered yes, considered that should Option 1 be recommended, the recommendation should also be inclusive of bonds that reset off swap curves based on GBP LIBOR, where they felt the successor should be the SONIA curve.
- **A small minority (2 out of 24 respondents)** answered no to Question 2.
    - Where a reason for answering no was given, or potential drawbacks to the approach identified alongside an answer of yes, three respondents noted that the selection of Option 1 would result in a lack of alignment with the recommendation of the Alternative Reference Rates Committee (“ARRC”) for USD LIBOR referencing bonds and/or of the Cross-Industry Committee on JPY Interest Rate Benchmarks for JPY LIBOR referencing bonds, whereby term reference rates came before compounded overnight rates in the waterfall of fallbacks.

Question 3: *If you answered "no" to question 2, do you consider that the recommended successor rate to GBP LIBOR for Type 2 fallbacks and Type 3 fallbacks should be term SONIA (Option 2) or any other SONIA based methodology? Please explain your answer.*

- Of the **two respondents** that answered no to Question 2, both considered that a form of term SONIA (Option 2) should be recommended. The following reasons were given:
    - There were sections of the market for which the compounded in arrears approach may not be desirable. E.g. Shifting from GBP LIBOR to overnight SONIA, compounded in arrears could create operational risks for those unaccustomed to dealing with the overnight compounding in arrears.
    - Term SONIA presented some advantages in terms of cash flow planning.
    - Term SONIA was aligned with ARRC's recommendation for USD LIBOR referencing bonds and was also likely to be aligned with 'synthetic LIBOR' the methodology for which would be based on forward looking SONIA Term Rate.
    - One respondent who answered no to Question 2 raised a question on whether the appropriate credit adjustment to be applied to term SONIA was the credit adjustment spread applicable to daily rates compounded in arrears.

Question 4: *Do you consider that details regarding further conventions to be used to accompany the successor rate, such as use of observation lag or shift, should be left to the issuer to agree on a case by case basis?*

- **A majority (17 out of 24 respondents)** answered yes to Question 4, that they considered details regarding further conventions to be used to accompany the successor rate, such as use of observation lag or shift, should be left to the issuer to agree on a case by case basis. It is worth noting that three out of the six investment / asset management firms answered no to Question 4, therefore the composition of those who responded no to this question was more concentrated amongst investment / asset management firms.
    - Where a reason for answering yes was given, the most common reason was a preference for a market led approach taking into account that conventions were still developing and already varied between bonds.
- **A minority (7 out of 24 respondents)** answered no to Question 4.
    - Where a reason for answering no was given, the most common reason was a desire for consistency. Some respondents also cited further mitigation of litigation risks to issuers and their independent advisors (including calculation / determination agents) and the avoidance of operational complexity.