CP 22/11: Winding down 'synthetic' sterling LIBOR and US dollar LIBOR

ICMSA Response

The International Capital Market Services Association ("**ICMSA**") is a London-based self-regulating organisation representing international financial and non-financial institutions active in the provision of services to the international capital markets. Our membership includes banks, registrars, stock exchanges, law firms, the International Central Securities Depositories ("**ICSDs**") and other service providers specialised in specific product segments. The primary purpose of the association is to foster the highest standards in the practice and management of international capital market services, thereby facilitating the efficient functioning of the market.

We welcome the opportunity to provide the views of the IBOR Transition Working Group of the ICMSA on the FCA's consultation paper ("**CP**") 22/11 regarding winding down 'synthetic' sterling LIBOR and US dollar LIBOR (the "**Consultation**").

We have responded to those aspects of the Consultation which most directly affect and impact our membership and give our views primarily in relation to the international capital markets, and in particular, with respect to legacy floating rate notes which reference LIBOR.

In producing this response, we have spoken with representatives of the International Capital Market Association ("**ICMA**"), who have kindly shared their own response to the Consultation with us. The ICMSA endorses and agrees with all of the responses provided by the ICMA.

Chapter 3 Synthetic sterling LIBOR

Q1a: Do you agree that the 1-month sterling LIBOR setting can be ceased in an orderly fashion at end-March 2023?

Q1b: Please explain your answer

Regardless of which LIBOR setting is proposed to be discontinued, it is imperative that there remain no meaningful risks of market disruption and litigation before the FCA takes the final decision to withdraw that particular setting. It is not possible to be completely certain or guarantee that all legacy contracts (whether bonds or otherwise) which reference a particular LIBOR setting have either been (i) transitioned to an alternative reference rate by any given date or (ii) otherwise have existing robust (and operationally workable) fallback mechanisms. However, our understanding is that the number of outstanding bond transactions which reference the 1-month sterling LIBOR setting is minimal, meaning that the risks associated with cessation are correspondingly reduced.[1] A substantive notice period which is widely communicated to the market, together with active messaging from the FCA, the BoE and trade associations will help to mitigate any such risk, noting that time is of the essence to achieve an orderly cessation by end-March 2023.

Q2a: Do you agree that the 6-month sterling LIBOR setting can be ceased in an orderly fashion at end-March 2023?

See our response to Question 1 relating to the 1-month sterling LIBOR setting, which also applies in response to this question.

Q2b: Please explain your answer

See our response to Question 1 relating to the 1-month sterling LIBOR setting, which also applies in response to this question.

[1] Regardless of this reduced risk profile, however, there would still be benefits in continuing to publish the 1-month sterling LIBOR setting given uncertainty of operation (and associated litigation risk) of dealer polls for securities which contain Type 1 fallbacks (see our response to Question 3a).

Q3a: Are there any reasons why you – or, if you are a trade body or professional services firm, your members or clients – will not be able to transition your 1- and / or 6-month sterling LIBOR exposures in the manner and timeframe we have assumed to be possible?

As we have highlighted in our response to previous FCA IBOR consultations, given the widespread use of LIBOR in the international capital markets throughout a range of bespoke contracts, it is likely to be challenging for the market to be in position to transition all legacy contracts in the short term and in particular by the end of March 2023. In our response to CP 21/29, we suggested that it is possible that at least some legacy LIBOR referenced securities (notably those denominated in sterling) will be outstanding beyond the maximum 10-year period for which the FCA can compel ICE Benchmark Administration to publish synthetic LIBOR.

We consider the following factors to be relevant:

- A particular issue of concern for the bond market is that a large number of legacy LIBOR bonds that currently reference synthetic LIBOR are likely to contain Type 1 fallbacks. As noted in our response to the FCA's consultation CP21/15, the paying agents amongst our membership have flagged that there will be significant practical challenges in operating Type 1 fallbacks which were not designed to deal with a permanent cessation of LIBOR. The primary issue is that the reference bank polling mechanism which is central to such Type 1 fallbacks is no longer fit for purpose in an environment where reference banks are unwilling (and potentially unable) to provide the quotations on which the fallback provisions are based. We refer to the paper set out in Annex 1 of our response to CP 21/29, which highlights the issues and concerns associated with the reference bank polling mechanism. An ICMSA bulletin was subsequently published on this topic. We urge the FCA to consider fully the practical and commercial challenges associated with operating Type 1 fallbacks if synthetic LIBOR was no longer available.

  The preferred position is that the dealer poll mechanism should be abandoned completely through legislative action, not least with a view to achieving parity with the legislation developed by the Alternative Reference Rates Committee in the US, which automatically disapplies such provisions. Absent such a legislative solution, the ICMSA would welcome formal (and binding) regulatory guidance from the FCA regarding the operation of dealer polls.[2]

- Given the wide distribution of a large proportion of securities to investors in a number of different jurisdictions, it may not always be possible to engage investors, in particular where legal restrictions may impact an issuer's ability to seek investors' consent (either at all or in a time/cost efficient manner). Therefore, it may be relatively simple to transition a privately placed bond held by limited numbers of known investors, but significantly more challenging in respect of public securities held across multiple jurisdictions.

[2] At a high level, any such the guidance would need to address best practice for operating a dealer poll and would cover topics such as (i) timeline, (ii) the steps to be followed (and for how long), (iii) the necessity for repetition of the dealer poll process at each payment date and (iv) an affirmative statement that there should be no expectation that reference bank sources will actually provide quotes as the result of these polls. A central database of institutions which are willing to act as reference bank sources (ideally with details of the relevant trading desks) would also help to minimise the risk of operational and payment delays.

We note in particular that in some cases (e.g., where there is a significant proportion of US investors[3], an orphan securitisation with insufficient funds or resources to transition actively or consent solicitations for securitisations with multiple classes of Notes which require the consent of all classes but which fail if one class of Noteholders fail to engage) the challenges faced by issuers to transition their debt on a voluntary basis are unlikely to be overcome by providing for more time to effect that transition.

- The current global sanctions environment also constitutes a further challenge to securing investor involvement and successful execution of consent solicitation processes to amend the relevant benchmark rate. Obligors and/or investors themselves may be sanctioned or the relevant trustee and/or corporate services provider may be prohibited from acting or assisting with the process by virtue of sanctions legislation.

- Consequently, whilst an issuer may be willing to proactively transition its legacy book of LIBOR-linked securities through the launch of consent solicitations to effect the relevant changes, it can prove difficult in practice to achieve the necessary quorum and consent thresholds. Whilst there have been a number of successful consent solicitations carried out to date, there have also been failures, which are largely beyond the issuer's control.

- Where issuers have launched a consent solicitation which has failed for lack of quorum/participation, they may view the cost, time and expense of launching a repeat transaction to outweigh the benefit, especially in circumstances where they do not expect a different outcome. The Consultation refers to other liability management tools such as buy backs or call options, but these won't always be available or commercially appropriate, especially where the cost of refinancing is high.

- As a result, it is likely that there will be a certain number of legacy deals that simply cannot be transitioned, regardless of the issuer's intentions. Such transactions will either need to rely on continued publication of synthetic LIBOR or be left to operate on the basis of any existing fallback arrangement, which may not be appropriate for use in the context of a permanent discontinuation of the relevant LIBOR setting. Such fallbacks themselves may also not be capable of being amended for the same reasons mentioned above. In addition to fallbacks, the FCA should be mindful of the practical consequences that might derive from retiring all but one of the LIBOR settings – in particular the risk that linear interpolation (or extrapolation) provisions are rendered inoperable or produce unintended results if there is a sole surviving setting.

Q3b: Where the answer is Yes, what asset class(es) and / or types of contract(s) do these exposures relate to, and which LIBOR setting do they reference?

See our response to Question 3a.

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[3] This is because the Securities and Exchange Commission ("**SEC**") rules requiring SEC registration of documentation for a deemed new issue of securities arising from a consent solicitation exercise are viewed by non-US issuers as onerous and costly and a significant barrier to involving US investors in consent solicitations. This means that securities with a high proportion of US investors are very unlikely to be transitioned successfully at any time unless there were to be: (a) significant divestment by US investors; or (b) an SEC no-action letter allowing issuers to involve US investors in their consent solicitation exercise without the need to comply with the relevant SEC requirements

Q3c: Please explain why these exposures cannot be transitioned in the manner and timeframe we've assumed to be possible, and what alternative timescale you think is needed.

See our response to Question 3a.

Q4: In your view, when would be the earliest date at which the 3-month sterling LIBOR setting could cease in an orderly fashion?

As noted in our response to Question 1, it is not possible to be completely certain or guarantee that all legacy contracts (whether bonds or otherwise) which reference a particular LIBOR setting have either been (i) transitioned to an alternative reference rate by any given date or (ii) otherwise have existing robust (and operationally workable) fallback mechanisms. Whilst the ICMSA is not in a position to provide a specific date which the 3-month sterling LIBOR setting could cease in an orderly fashion, given that we understand that the volume of such legacy transactions is material (especially when compared to other legacy transactions which reference the 1-month and 6-month sterling LIBOR settings), the ICMSA encourages the FCA to keep under review the number of legacy sterling LIBOR transactions, their maturity profile and likely contractual fallbacks with a view to assessing the right time to cease publication of the 3-month synthetic sterling LIBOR setting.

Subject to relevant data being received from market participants regarding the volume of affected legacy transactions, the ICMSA is supportive of an extension of the publication of the 3-month sterling LIBOR setting in order to implement a properly managed and orderly wind-down. Whilst it is appreciated that the FCA's intention is to transition away from the use of all LIBOR settings as promptly as possible, the challenges and risks posed by a premature transition away from a LIBOR setting which remains widely used in the market appear to outweigh any disadvantages of continuing to publish such LIBOR setting on a synthetic basis.

Q5a: Do you – or if you are a trade body or professional services firm, your members or clients – have exposures linked to 3-month sterling LIBOR where you have encountered, or expect to encounter, obstacles that prevent you from completing transition by end-March 2023?

See our response to Question 3 relating to the 1-month and 6-month sterling LIBOR settings, which also apply in response to this question.

Q5b: Where the answer is Yes, what asset class(es) and / or types of contract(s) do these obstacles relate to?

See our response to Question 3 relating to the 1-month and 6-month sterling LIBOR settings, which also apply in response to this question.

Q5c: Please provide details of these obstacles, how you intend to overcome them and to what timescale?

See our response to Question 3.

Q6a: Do you – or, if you are a trade body or professional services firm, your members or clients – have any specific contracts, or classes/types of contracts, linked to 1-, 3- or 6-month sterling LIBOR that you consider will be unable to cope with cessation regardless of the time available - because they do not have workable fallbacks, cannot be transitioned away, and cannot cease prior to maturity without causing disruption?

See our response to Question 3 and Question 4.

Q6bi: Where the answer is Yes, what type of contract(s) are they?

See our response to Question 3 and Question 4.

Q6bii: Which LIBOR setting(s) do they reference?

1-, 3- and 6-month sterling LIBOR.

Q6biii: How many contracts are there?

Q6biv: What is their approximate total value?

Q6bv: When are they due to mature?

Q6c: For each type of contract, please explain the precise reasons why you consider they cannot transition, and what the impact on the contract would be if the relevant sterling LIBOR setting ceased?

See our responses above, in particular to Question 3.

Chapter 4: US dollar LIBOR

Q7a: Do you agree it will be possible to transition remaining exposures to US dollar LIBOR in line with our assumptions?

Q7b: Please explain your answer

- We expect that it will be extremely challenging to transition outstanding securities which reference US dollar LIBOR in line with the FCA's assumptions.

  - Primarily, it is widely acknowledged (and market data shows – see, for example, the Bloomberg data referenced in the ICMA's response to the Consultation) that US dollar LIBOR is much more widely used throughout the international capital markets than sterling LIBOR. The scale of the challenge to transition outstanding US dollar LIBOR securities is significantly greater than that posed by sterling LIBOR securities. Although the transition period for US dollar LIBOR securities has already been extended, the focus to date has been on the sterling and Japanese yen markets, such that a relatively small proportion of US dollar contracts have been actively transitioned. Whilst this will be mitigated to a material extent by federal legislation in the US, there remains no legislative solution for non-US law governed contracts.

  - In addition, the holder base of US dollar LIBOR securities is typically much more diverse than that for sterling LIBOR securities, meaning that the issues highlighted with respect to the transition of sterling LIBOR securities are exacerbated. In particular, the ability to reach holders (some of whom are expected to be retail holders, particularly in the Asian market) as part of any consent solicitation exercise is likely to present a significant challenge. Putting aside local legal considerations of conducting a consent solicitation exercise in any given jurisdiction, investor engagement and awareness is expected to be a further practical hurdle to effecting changes to the terms of legacy securities. We also refer to our response to Question 3a and the concerns expressed regarding the current sanctions environment, which would apply equally to any consent solicitation exercises in respect of legacy US dollar LIBOR securities.

- As with sterling LIBOR, an extension of US dollar LIBOR beyond June 2023 by publication of a synthetic form of US dollar LIBOR (with broad legacy use permissions) would significantly help to ease the transition in a smooth and orderly manner with minimal market disruption (and associated litigation). In particular, it would avoid US dollar LIBOR securities governed by English law which contain Type 1 fallbacks reverting to a fixed rate after 30 June 2023, when most US dollar LIBOR securities governed by a US law remain on a floating rate pursuant to US federal legislation. The same issues highlighted in our response to Question 3 regarding Type 1 fallback mechanisms would also become relevant.

- In that respect, and in order to ensure international consistency, any synthetic US dollar LIBOR rate should be aligned to the rate expected to apply under the US Adjustable Interest Rate (LIBOR) Act of 2021 (i.e. term SOFR plus an adjustment spread, as expected to be published by Refinitiv in September 2022[4]). It would be an unsatisfactory outcome, and

[4] https://www.refinitiv.com/en/media-center/press-releases/2022/july/refinitiv-to-launch-forward-looking-term-rate-versions-of-arrc-recommended-fallback-rates

increase the risk of a disorderly transition, if economically equivalent US dollar LIBOR securities were to be treated differently simply by reason of their governing law (especially if those securities are issued by the same issuer). A consistent international approach is therefore essential in achieving an orderly transition.

Q8a: Do you – or if you are a trade body or professional services firm, your members or clients – have exposures to US dollar LIBOR where you have encountered, or expect to encounter, obstacles that prevent you from completing transition by end-June 2023?

Q8b: Where the answer is Yes, what asset class(es) and / or types of contract(s) do these obstacles relate to?

Q8c: Please provide details of these obstacles, how you intend to overcome them and to what timescale?

Q8d: Where these contracts are governed by laws other than US or UK law, please provide details of any contract language or provisions that mean our assumptions are not appropriate and require adjustment.

See our response to Question 7.

Q9a: Do you – or, if you are a trade body or professional services firm, your members or clients – have any specific contracts, or classes/types of contracts, linked to US dollar LIBOR that you consider will be unable to cope with cessation regardless of the time available - because they do not have workable fallbacks, cannot be transitioned away, and cannot cease before maturity without causing disruption?

Q9bi: Where the answer is Yes, what type of contract(s) are they?

Q9bii: Which LIBOR setting(s) do they reference?

Q9biii: How many contracts are there?

Q9biv: What is their approximate total value?

Q9bv: When are they due to mature?

Q9bvi: What is the relevant governing law?

Q9c: For each type of contract, please explain the precise reasons why you consider they cannot transition, and what the impact on the contract would be if the relevant US dollar LIBOR setting ceased?

See our responses above, in particular to Question 7.

Q10: What impact would publication of a synthetic US dollar LIBOR rate have? Would there be any unintended adverse consequences?
Please provide details of why and whether this is relevant to specific contracts.

- See our response to Question 7.

- Based on our members' experience of synthetic sterling LIBOR, we are not aware of any unintended adverse consequences that may be caused by publication of a synthetic US dollar LIBOR rate. Absent a legislative solution akin to that in the US, the ICMSA is supportive of the publication of synthetic US dollar LIBOR and would welcome further engagement with the FCA regarding the timing for its introduction and the scope of its application.