

# Consultation on 'synthetic' US dollar LIBOR and feedback to CP22/11

**Consultation Paper**

CP22/21

November 2022

## How to respond

We are asking for comments on this Consultation Paper (CP) by **6 January 2023**.

You can send them to us using the form on our [website](#).

Or in writing to:

Benchmarks Policy  
Financial Conduct Authority  
12 Endeavour Square  
London E20 1JN

**Email:**

cp22-21@fca.org.uk

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# 1 Summary

- 1.1** In June 2022, we consulted on ceasing 'synthetic' sterling LIBOR. We also sought information on US dollar LIBOR exposures in order to help us assess whether to require continued publication of US dollar LIBOR on a synthetic basis for a limited period after the end of the US dollar LIBOR panel at end-June 2023.

## US dollar LIBOR

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- 1.2** In the consultation, we sought information on the size and nature of exposures to the remaining US dollar LIBOR settings, and market participants' plans to transition these exposures away from LIBOR before end-June 2023 when the US dollar LIBOR panel will end. We also sought views on any challenges or issues that might result from the publication of any of the 1-, 3- and 6-month US dollar LIBOR settings on a synthetic basis.
- 1.3** Chapter 3 provides feedback to the responses we received relating to US dollar LIBOR. Having considered these responses, we think there is a case for:
- requiring publication of the 1-, 3- and 6-month synthetic US dollar LIBOR settings for a short period of time, ie until end-September 2024
  - permitting use of these synthetic US dollar LIBOR settings in all contracts except cleared derivatives

## Synthetic sterling LIBOR

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- 1.4** Having taken account of feedback received to our June consultation, we confirmed on 29 September 2022 our decision to allow 1- and 6-month sterling LIBOR to cease at end-March 2023. Today we have announced that we intend to compel LIBOR's administrator ICE Benchmark Administration Limited (IBA) to continue publishing 3-month sterling LIBOR until end-March 2024, after which it will also cease permanently.
- 1.5** We provide feedback to the responses we received to our consultation relating to these sterling LIBOR settings in chapter 4.

## What we are consulting on

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- 1.6** We are now seeking views on our proposal to require publication of the 1-, 3- and 6-month US dollar LIBOR settings on a synthetic basis until end-September 2024, as well as on the appropriate methodology for constructing such synthetic US dollar LIBOR settings, and what use of them should be permitted.

- 1.7** As we have said previously, while in our view synthetic LIBOR settings are a fair and reasonable approximation of what LIBOR might have been had it continued to exist, they are not representative of the markets that the original LIBOR settings were intended to measure.
- 1.8** The Benchmarks Regulation (BMR) grants the FCA powers to designate certain unrepresentative benchmarks as permanently unrepresentative 'Article 23A' benchmarks. This designation results in a prohibition on supervised entities from using the benchmark in contracts within scope of the BMR, except for legacy (ie existing) contracts specifically permitted by the FCA – the 'legacy use power'. Paragraphs 3.70 to 3.71 of chapter 3 set out how we propose we would use this power in relation to the 1-, 3- and 6-month synthetic US dollar LIBOR settings.
- 1.9** The designation as a permanently unrepresentative benchmark also empowers the FCA to require the administrator of the benchmark, or benchmark setting, to change the way the benchmark or setting is determined – the 'methodology change power'. Paragraphs 3.45 and 3.46 of chapter 3 set out how we propose we would use this power in relation to the 1-, 3- and 6-month US dollar LIBOR settings. Under our proposals here, synthetic US dollar LIBOR would be the sum of the CME Group Benchmark Administration Limited's (CME's) Term SOFR Reference Rate plus the International Swaps and Derivatives Association (ISDA) fixed spread adjustment for the corresponding LIBOR setting.
- 1.10** Our previously published overview document sets out more detail on our powers under the BMR.

## Who this applies to

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- 1.11** We expect that this document will be of interest to:
- regulated and unregulated users of LIBOR, both within and outside the UK
  - service providers for LIBOR-linked contracts and/or users of LIBOR, such as lawyers, agents, advisers and third-party administrators
  - the administrator of LIBOR
  - providers of relevant inputs to a potential synthetic US dollar LIBOR
  - other stakeholders with an interest in the orderly wind-down of LIBOR

Given the wide use of US dollar LIBOR around the world, we strongly encourage market participants from outside, as well as within, the UK to respond to all questions in this consultation that are relevant to them.

## Next steps

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- 1.12** We are seeking responses to this consultation by 6 January 2023.
- 1.13** You can respond using one of the forms described on page 2 'how to respond'.

- 1.14** We will consider feedback to this consultation when making our decisions in relation to US dollar LIBOR. We will communicate to the administrator of LIBOR, users of LIBOR and the wider market in a clear and transparent way any final decision(s) to use our powers, including publishing notice(s) in line with the requirements of the BMR.
- 1.15** We also remind market participants that the synthetic yen LIBOR settings will cease at end-2022, and market participants using these rates must take the necessary action to prepare for this.

## 2 The wider context

### LIBOR transition

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- 2.1** We, alongside the Bank of England, other regulators internationally, and industry working groups in the LIBOR currency jurisdictions, have been encouraging transition away from LIBOR to alternative Risk-Free Rates (RFRs).
- 2.2** Sterling Overnight Index Average (SONIA) compounded in arrears is now the foundation of sterling interest rate markets and is used across a wide range of products. The Secured Overnight Financing Rate (SOFR), recommended by the US national industry working group, the Alternative Reference Rates Committee (ARRC), as the replacement for US dollar LIBOR, is now the predominant reference rate used in US dollar markets, including in cash markets. We encourage market participants to continue to transition to robust risk-free or near-risk-free rates, and not to reintroduce weaknesses into the financial system by using fragile reference rates.
- 2.3** We have also been encouraging adoption of robust fallbacks, including wherever practicable their insertion into existing legacy LIBOR contracts, so that contracts continue to operate when LIBOR settings cease or become permanently unrepresentative.
- 2.4** On 31 December 2021, publication of 24 of the then-remaining 35 LIBOR settings ended. Since that date, we have required IBA, the administrator of LIBOR, to continue publication on a synthetic (and therefore unrepresentative) basis of the 1-, 3- and 6-month sterling and yen LIBOR settings, to give the holders of certain legacy contracts more time to complete transition. The 3 synthetic yen LIBOR settings will cease permanently at end-2022. The 1- and 6-month synthetic sterling LIBOR settings will cease permanently at end-March 2023. As we have announced today, we intend to compel LIBOR's administrator, IBA, to continue publishing the 3-month synthetic sterling LIBOR setting until end-March 2024, after which it will also cease permanently.
- 2.5** The overnight, 1-, 3-, 6- and 12-month US dollar LIBOR settings will continue to be published in their representative, panel-based form until end-June 2023, when the US dollar LIBOR panel will end. Use of these 5 settings in new contracts has been restricted since the start of 2022, and market participants should continue to progress their work to convert outstanding legacy contracts.
- 2.6** There is significant exposure to US dollar LIBOR outside the US, including in the UK. The ARRC estimated in 2021 that globally, over US\$70 trillion of US dollar LIBOR exposures would remain outstanding beyond the cessation of the US dollar LIBOR panel at end-June 2023.
- 2.7** In the US, federal legislation (the Adjustable Interest Rate (LIBOR) Act (the LIBOR Act)) was enacted in March 2022 to establish a process to move contracts governed by US law that contain no, or unworkable, fallbacks, to alternative rates when the US dollar LIBOR panel ends.

- 2.8** We said in our June consultation that, in due course, we would assess whether the US dollar LIBOR settings can be wound down in an orderly fashion without requiring publication of a synthetic rate, taking into account transition of exposures outside the US. Having considered responses to our consultation, we expect that there will be a pool of outstanding legacy contracts governed by UK or other non-US law, that are not covered by the LIBOR Act and that have no realistic prospect of being amended to transition away from the 1-, 3-, and 6-month US dollar LIBOR settings by end-June 2023. Therefore, to ensure an orderly wind-down and in line with our objectives, we think there is a case for requiring continued publication of 1-, 3- and 6-month US dollar LIBOR using a synthetic methodology, for a limited time. We have said previously that we did not think there was a case for publication on a synthetic basis of overnight or 12-month US dollar LIBOR. Responses to our June consultation did not yield any information to alter our view. Those 2 settings will cease permanently after final publication on 30 June 2023.
- 2.9** Final decisions relating to synthetic publication of the 1-, 3- and 6-month US dollar LIBOR settings (ie whether to require publication on a synthetic basis, and, if so, the methodology to be used to do so, and what use in legacy contracts should be permitted) will be made after this consultation has closed and will take account of responses received.

## How it links to our objectives

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- 2.10** The FCA's statutory objectives require us to:
- secure an appropriate degree of protection for consumers
  - protect and enhance the integrity of the UK financial system
- 2.11** A disorderly end to any LIBOR setting could impact adversely the integrity of the UK financial system and/or harm consumers. This consultation seeks views on how best we can avoid this and instead achieve an orderly wind-down of LIBOR.

## Equality and diversity considerations

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- 2.12** We have considered the equality and diversity issues that may arise from the proposals in this publication.
- 2.13** Overall, we do not consider that the proposals materially impact any of the groups with protected characteristics under the Equality Act 2010. But we will continue to consider the equality and diversity implications of the proposals during the consultation period and when making any future decisions.
- 2.14** In the meantime, we welcome your input to the consultation on this.

## Information we use to inform our decision-making

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- 2.15** When making decisions relating to the orderly wind-down of LIBOR, we will take account of relevant data and information available to us. This includes information presented to us by market participants and their representatives, the administrator of LIBOR, LIBOR users, national working groups and overseas authorities – including information and data supplied to us in consultation responses. Where we do not have precise information, we will apply assumptions and estimates based on the information that is available.



## 3 Further consultation on US dollar LIBOR

### Whether US dollar LIBOR can cease in an orderly fashion at end-June 2023

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- 3.1** In our June consultation, we set out our expectation and assumptions that the additional 18 months of panel bank US dollar LIBOR had provided market participants with considerable extra time to transition away to suitable replacement rates, as well as allowing more legacy contracts to reach maturity.
- 3.2** Our assumptions focused on US dollar LIBOR contracts not governed by US law. US federal legislation enacted in March 2022 - the LIBOR Act - provides for contracts governed by US law that reference US dollar LIBOR and contain no, or unworkable, fallbacks. For these contracts, references to LIBOR will be replaced, by operation of law, with a SOFR-based benchmark replacement that the Federal Reserve Board (FRB) will identify in regulations. The LIBOR Act also provides a 'safe harbour', under which a party who has discretion to select a successor rate may choose the benchmark replacement identified by the FRB with certain protections against liability for doing so. The FRB published its proposed [rule](#) implementing the LIBOR Act in July 2022.
- 3.3** We said that there may be exposures of which we were not currently aware, or other local factors which we should consider. We asked respondents to help us test our assumptions by providing relevant information. We sought to establish whether there are any insurmountable barriers to a smooth transition of US dollar LIBOR-referencing contracts to alternative rates before or upon the cessation of the US dollar LIBOR panel (Question 7 in our June consultation) and, if so, the size and nature of any exposures affected by these barriers (Questions 8 and 9 in our June consultation).
- 3.4** We received more than 50 responses to each of these questions. The majority of respondents (31, including 7 trade associations) said that while they expect the majority of outstanding contracts to transition away by end-June 2023, there will likely remain a small but material subset of contracts governed by non-US law referencing US dollar LIBOR that will not be able to transition away by end-June 2023. Most respondents provided qualitative information and some respondents (including 1 trade association) provided quantitative data on exposures. A few respondents noted that the overall estimated volume of legacy contracts referencing US dollar LIBOR and governed by non-US law remaining at end-June 2023 is likely to be above the total volume of outstanding contracts referencing sterling and yen LIBOR at end-2021, and that there is a more diversified investor base for US dollar LIBOR contracts, making transition more challenging. We note in particular that there are significant numbers of bonds and securitisations referencing US dollar LIBOR that are governed by UK law, which could benefit from an additional period of time to organise change through consent solicitations. We also note information that progress on transition away from US dollar LIBOR in lending agreements in developing countries may be less advanced than in jurisdictions such as the UK, where LIBOR transition has had a higher profile. These jurisdictions and counterparties to these contracts may also benefit from some additional time to complete transition.

**3.5** We are encouraged by the overall positive progress in US dollar LIBOR transition and encourage market participants to continue the momentum. We do not consider that the transition challenges mentioned by respondents are insurmountable. However, we recognise the overall feedback that a short additional period beyond end-June 2023 of publication on a synthetic basis may help market participants to remove the dependency of a small but material population of legacy contracts referencing US dollar LIBOR.

### **A time-limited continuation using a synthetic methodology**

**3.6** Question 10 in our June consultation asked about the likely impact of a synthetic US dollar LIBOR. We received 53 responses, from within and outside the UK, the majority of which were from financial institutions. Twenty-nine responses were from globally active firms and 9 were from trade associations (including 6 international and 3 regional). There were also responses from 2 non-financial corporates, 1 non-UK public authority and 1 individual.

**3.7** The vast majority of respondents (40 out of 53) said that publication of US dollar LIBOR under a synthetic methodology for a limited period of time after end-June 2023 would be helpful to support ongoing transition and to ensure an orderly wind-down. Eight respondents didn't express a clear view on this, while 5 objected to a synthetic US dollar LIBOR. We cover these views in more detail in paragraphs 3.12 to 3.15 below.

**3.8** We have been clear, since March 2021, that we will only consider synthetic US dollar LIBOR for the widely used 1-, 3- and 6-month settings. Taking account of the feedback received, we think there is a case for our requiring publication of these 3 US dollar LIBOR settings to continue for a short period of time using a synthetic, unrepresentative methodology. This is similar to what we did for some sterling and yen LIBOR settings. It would be consistent with our published policy, in that it appears likely that there will be material amounts of legacy contracts at end-June 2023 which either do not contain fallbacks, or have inappropriate fallbacks and cannot practicably be transitioned away by end-June 2023.

**3.9** Based on information available to us on transition progress, we think it likely that a further 15 months, on top of the additional 18 months of panel bank US dollar LIBOR (ie until end-September 2024), 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.

**3.10** Therefore, we are now seeking views from market participants on our proposal to require publication of the 1-, 3- and 6-month LIBOR rates on a synthetic basis until end-September 2024, as well as on the methodology we propose to require for continued publication of these 3 settings, and what use by market participants of these 3 settings in legacy contracts should be permitted after end-June 2023.

**3.11** Publication of synthetic 1-, 3- and 6-month US dollar LIBOR settings would rely on the FCA compelling the administrator of LIBOR to continue to publish these settings and designating them as permanently unrepresentative 'Article 23A' benchmarks. We will make our decisions in this regard after this consultation has closed, taking account of relevant information and data available, including feedback received to this consultation, and consistent with the requirements of the BMR.

## Consequences of a synthetic US dollar LIBOR

- 3.12** Question 10 of our June [consultation](#) also asked for views on any unintended consequences of a synthetic US dollar LIBOR if we were to require one to be published.
- 3.13** Among those who supported a synthetic LIBOR (40 out of 53), 10 respondents said that it would slow down transition efforts. However, several of them suggested that this could be mitigated by a clear FCA statement on the temporary nature of a synthetic US dollar LIBOR. Three respondents mentioned that there could be implications arising from a synthetic US dollar LIBOR for non-UK law governed contracts, citing reasons including the interaction with the US' LIBOR Act and potentially different interpretations of the effect of a synthetic LIBOR in other jurisdictions. Two respondents noted the inoperability of cessation fallbacks if LIBOR continued to be published under a synthetic methodology.
- 3.14** These are the same issues noted by respondents who did not support publication of a synthetic US dollar LIBOR. Two non-UK-based respondents mentioned the potential implications for contracts governed by US law that are not covered by the LIBOR Act. Two other non-UK-based respondents were concerned about the disincentivising effect on continued transition. One individual bond holder noted that the cessation fallback contained in the bonds they held would not come into effect while a synthetic US dollar LIBOR is published.
- 3.15** Among those who did not express a clear view on whether a synthetic US dollar LIBOR would be needed, 3 respondents were concerned about disincentivising transition, 3 expected no exposure to synthetic US dollar LIBOR, and 1 EU-based respondent asked for a permanent statutory replacement rate.
- 3.16** Our June [consultation](#) did not ask for views on the appropriate length of continued publication of US dollar LIBOR under a synthetic methodology after end-June 2023, but 7 respondents commented on this. Their views varied, from a maximum of 1 year or less, to a maximum of 10 years. Those who asked for a shorter publication period highlighted that it is important to be clear on the temporary nature of any synthetic LIBOR and not to disincentivise transition.
- 3.17** Under the BMR, we are required to review any compulsion decision before the end of the relevant compulsion period to assess whether an extension is necessary for an orderly wind-down. We consider that it is possible for cessation to be orderly even if not every contract has transitioned away or been equipped with a workable fallback, provided there is not sufficient scale of un-remediated contracts to pose a threat either to market integrity or to an appropriate degree of protection for consumers.
- 3.18** Once outstanding contracts that still reference a particular LIBOR setting have had sufficient time to transition to an alternative benchmark, or to make provision to do so upon cessation of the LIBOR setting, it may no longer be appropriate for us to require continued publication.
- 3.19** We have been clear that any publication of synthetic LIBOR is temporary and intended to provide a bridge for contracts to transition to relevant RFRs. We have set out our initial view in paragraph 3.9 above that a further 15 months after end-June 2023 should provide sufficient extra time for an orderly wind-down. We remind market participants not to rely on a temporary, synthetic US dollar LIBOR.

**3.20** We are mindful of the need to balance the interests of borrowers and lenders without fallbacks against those of borrowers and lenders whose contracts do contain cessation fallbacks, and whose operation will be delayed by publication of a synthetic US dollar LIBOR; and also the imposition of requirements on LIBOR's administrator, IBA, which would be required to continue to publish LIBOR in an unrepresentative form. The extra time provided by synthetic US dollar LIBOR should allow parties with contracts governed by non-US law to continue to transition away. We discuss the potential interaction of a synthetic US dollar LIBOR with the US' LIBOR Act in paragraphs 3.59 to 3.66 below.

### Other relevant responses

**3.21** One respondent asked us to issue a definitive statement announcing the future cessation and/or loss of representativeness of US dollar LIBOR to help facilitate active transition, suggesting our March 2021 statement was helpful for sterling LIBOR.

**3.22** We remind market participants that our [March 2021 statement](#) on the future cessation and loss of representativeness of LIBOR confirmed that all LIBOR settings will either cease to be provided by any administrator or no longer be representative – including all US dollar settings:

- immediately after 31 December 2021, in the case of all sterling, euro, Swiss franc and Japanese yen settings, and the 1-week and 2-month US dollar settings
- immediately after 30 June 2023, in the case of the remaining US dollar settings

**3.23** We made this statement in the awareness that it would engage certain contractual triggers in contracts for the calculation and future application of fallbacks that are activated by pre-cessation or cessation announcements made by us (howsoever described). Nothing in this consultation paper changes the facts in or validity of that statement.

**3.24** Five respondents noted the ongoing consideration of the appropriateness of the various forms of SOFR rates for cash products and the use restriction of term SOFR rates in derivatives. These, in their view, could delay US dollar LIBOR transition.

**3.25** We, in line with the US authorities, encourage market participants to transition to robust SOFR rates where practicable. While term RFR rates have proven to be a useful additional tool for LIBOR transition, they are different from other forms of RFRs (eg overnight, compounded in arrears and averages) because term RFRs are based on derivative market transactions, and they rely on the continued existence of a deep and liquid derivatives market based on overnight RFRs. There has been wide acknowledgement that the bulk of derivative transactions should be based on underlying overnight index swaps (OIS) and futures markets, as these are a necessary foundation for constructing and sustaining robust term RFRs. Thus, use of term RFRs in derivative markets should remain limited so that term RFRs can continue to be available on a sustainable basis for the limited appropriate use cases. We remind market participants that the use of term SOFR rates should be limited in line with recommendations issued by the [ARRC](#) and the [Financial Stability Board \(FSB\)](#), in order to remain compatible with the integrity of the financial system.

**3.26** Two respondents flagged that a small population of non-US law governed floating rate bonds, which do not contain workable fallbacks, require a very high consent threshold (95% to 100%) to transition away. We recognise that it may take longer or be more challenging to remediate these contracts. A time-limited synthetic US dollar LIBOR after end-June 2023 should provide extra time for parties to remediate these, though this may not be successful in all cases. We think that given the small population of these contracts, they should not pose a risk of material disruption to an orderly wind-down overall.

**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?**

## **Methodology for a synthetic US dollar LIBOR after end-June 2023**

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**3.27** We have set out below:

- how our previous analysis and decision to require a synthetic methodology for certain sterling and yen LIBOR settings are also relevant to a methodology for synthetic US dollar LIBOR – see paragraphs 3.28 to 3.44
- our proposed approach to the methodology of synthetic US dollar LIBOR – see paragraphs 3.45 and 3.46

### **Previous analysis and decision to require a synthetic methodology for certain sterling and yen LIBOR settings**

**3.28** Last year we considered whether and how to require a methodology change for the 1-, 3-, and 6-month sterling and yen LIBOR settings once the relevant LIBOR panels ended at end-2021. Our aim was to ensure an orderly wind-down and to advance our consumer protection and market integrity objectives.

**3.29** In June 2021, we consulted on a proposal to require IBA to change the way the relevant sterling and yen LIBOR settings were determined using a modified, synthetic methodology based on the sum of the relevant forward-looking term rate plus the ISDA fixed spread adjustment for the corresponding LIBOR setting. Our consultation set out in detail how we had taken account of our published [policy](#) in arriving at this proposal. This included setting out the appropriateness and desirability of using our power to require a methodology change, and various factors in considering what the methodology should be, including fair approximation of LIBOR, market support, least disturbance to affected parties, availability of robust and transparent inputs to the administrator of LIBOR, impact on the administrator, length of publication and likely effects outside the UK.

**3.30** We considered that, given the existence and scale of legacy LIBOR-referencing contracts that would be adversely affected, it was desirable to use our methodology change power to advance consumer protection and market integrity. In doing so, contracts would continue to function as intended and consumers would achieve fair outcomes as LIBOR continued under a robust, synthetic methodology. It would also avoid market disruption and maintain the 'orderliness', 'resilience' and 'cleanliness' of the UK financial system.

- 3.31** Based on information available to us, we considered that the 1-, 3- and 6-month sterling and yen LIBOR settings would not be able to cease in an orderly fashion at end-2021 due to significant legacy exposures and that there was no sensible way to sustain these settings after panel submissions ended other than to require a synthetic methodology.
- 3.32** We concluded that it was appropriate to use our methodology change power in order to secure an orderly cessation of the relevant LIBOR settings and to advance our consumer protection and market integrity objectives. This decision was made in conjunction with both our decision to compel IBA to continue to publish these settings after end-2021 for a 12-month period, and our decision to designate these settings as permanently unrepresentative at end-2021 once the relevant LIBOR panels ended.
- 3.33** We considered that a synthetic methodology based on the relevant forward-looking RFR term rate (term SONIA for sterling and term Tokyo Overnight Average Rate (TONA) for yen) plus the ISDA fixed spread adjustment would achieve a fair and reasonable approximation of the value that sterling and yen LIBOR would have had. Taking into account the established market support where relevant, we chose IBA's term SONIA and QUICK Benchmark Inc's Tokyo Term Risk Free Rates (TORF) for the specific purpose of producing synthetic sterling and yen LIBOR rates (see also paragraph 3.38 below).
- 3.34** In line with other factors under our policy framework, our synthetic methodology ensured that there was the least disturbance or disadvantage to affected parties. This is because it minimised the need for parties to make consequential changes to ensure their contracts continued to operate after LIBOR panels ended, and was based on inputs that are visible and available to market participants should they choose to continue the use of those inputs after the end of any synthetic LIBOR.
- 3.35** Component inputs of the methodology were robust and transparent in line with the BMR, IOSCO principles for financial benchmarks and equivalent requirements. They were available to the administrator of LIBOR, without the administrator being subject to unreasonable financial or commercial loss. We also considered information and data available to us on the likely effect of synthetic sterling and yen LIBOR outside the UK and concluded that there was support for a synthetic LIBOR to ensure an orderly wind-down both within and outside the UK.
- 3.36** These considerations are set out in full in paragraphs 3.2 to 3.67 of our June 2021 consultation.

### **Synthetic US dollar LIBOR**

- 3.37** We have outlined our view that there is a case for requiring publication of 1-, 3- and 6-month US dollar LIBOR settings under a synthetic methodology after end-June 2023 to allow more time for legacy contracts to transition away, given the extensive use of US dollar LIBOR outside of the US, as we set out in paragraphs 3.1 to 3.5 above and in line with our published policy framework.
- 3.38** In our June consultation, we said that we expected any synthetic US dollar LIBOR to follow a similar model to sterling and yen, ie a forward-looking term rate derived from the RFR (ie SOFR for US dollar), plus the respective ISDA fixed spread adjustment, in line with our published policy framework. Our policy framework says that we would take into account whether market support had already been established, through

public or private sector-led working groups, and/or open consultation, on a fair way of calculating a replacement value for the relevant benchmark. It also says that we would take into account other factors, including the availability of robust and transparent inputs to the administrator of LIBOR and likely effects outside the UK.

- 3.39** For US dollar LIBOR, the ARRC formally recommended the term SOFR Reference Rates produced by CME as an alternative reference rate for US dollar LIBOR in certain cases where such use is in line with its Best Practice Recommendations, including in legacy contracts that have adopted ARRC fallback language. In July 2022, the FRB proposed in its rule to implement the US' LIBOR Act, mentioned in paragraph 3.2, to use CME Term SOFR Reference Rates that incorporated spread adjustments specified in the LIBOR Act as benchmark replacement rates for LIBOR for non-derivative products.
- 3.40** We said in June 2022 that a model using the ARRC's recommended term SOFR rates would depend on CME Term SOFR Reference Rates being available to IBA for use in a synthetic rate under an agreement acceptable to both parties.
- 3.41** The majority of the respondents to our question about the impact of a potential synthetic LIBOR (40 out of 53), supported a synthetic US dollar LIBOR. Among these, 20 respondents (including 5 trade associations) highlighted the importance of international consistency. They noted that a synthetic US dollar LIBOR should be the same as, or as close as possible to, the solution under the US' LIBOR Act to avoid bifurcation between legacy US dollar LIBOR contracts governed under non-US law and US law. Five respondents explicitly asked for a synthetic US dollar LIBOR to be based on the CME Term SOFR Reference Rate plus the respective ISDA fixed spread adjustment (the ISDA fixed spread adjustments are identical to the spread adjustments specified in the LIBOR Act). We agree with respondents on the importance of maintaining international consistency to avoid market fragmentation or unwanted basis risk, where practicable.
- 3.42** Overall, we have concluded that we should follow the same approach for US dollar LIBOR settings as for sterling and yen LIBOR settings, in line with our policy framework. We propose to use our methodology change power for the 1-, 3- and 6-month US dollar LIBOR settings in the same way as we did for sterling and yen LIBOR.
- 3.43** There are 2 Term SOFR reference rates available, produced by CME and IBA respectively. We have assessed both rates in line with our published policy framework. Both rates are robust and transparent in line with BMR requirements. We considered that the CME Term SOFR Reference Rate will better satisfy our policy consideration of market support and the likely effect outside the UK, in light of the ARRC's recommendation and the proposed regulation by the FRB to implement the US' LIBOR Act, as mentioned in paragraph 3.39 above.
- 3.44** In light of these considerations, we prefer to use the CME Term SOFR Reference Rate for the specific purpose of producing a synthetic US dollar LIBOR. We have been informed by both CME and IBA that they expect the CME Term SOFR Reference Rate will be made available to IBA for this purpose and that IBA will be operationally able to produce a synthetic US dollar LIBOR rate using this input.

## Our proposed approach

**3.45** We propose that a 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, ie for the 1-, 3-, and 6-month US dollar LIBOR settings respectively.

**3.46** Each of the settings should continue to be published at or around 11:55am London time on each applicable London business day, which excludes weekends and London public holidays, for as long as we continue to compel IBA to determine and publish the relevant setting.

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

**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?**

## Permitted legacy use of a synthetic US dollar LIBOR

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**3.47** As with the methodology change power, we have drawn on experience with the approach we took to sterling and yen LIBOR settings last year to inform our proposals. We have considered the information available to us on the degree to which the circumstances relating to the use of US dollar LIBOR settings in legacy contracts are similar to those in relation to the use of the sterling and yen LIBOR settings. As such, we have summarised below:

- our previous analysis and decision to permit use of synthetic sterling and yen LIBOR settings – see paragraphs 3.48 to 3.53
- how these considerations apply to synthetic US dollar LIBOR – see paragraphs 3.54 to 3.69
- our proposed approach – see paragraphs 3.70 and 3.71

## Previous analysis and decisions to permit use of synthetic LIBOR settings

**3.48** In September 2021, we consulted on a proposal to permit legacy use of the planned synthetic sterling and yen LIBOR settings in all contracts except cleared derivatives (whether directly or indirectly cleared). Our consultation set out in detail how we had taken account of our published policy in arriving at this proposal, including setting out the mechanisms available for, and the likely challenges and obstacles to, transitioning bonds, mortgages, loans and investment funds away from LIBOR to use appropriate alternative rates.

**3.49** We concluded that there were considerable barriers to transitioning existing contracts away from LIBOR within the time available prior to the ending of the sterling and yen LIBOR panels. Whilst appropriate alternative rates were available, and in most cases mechanisms were available for parties to amend their contracts, we accepted that additional time would be required to complete this process given the obstacles and challenges to be overcome, and the volume of contracts involved.

**3.50** Overall, we considered that there were risks to market integrity and consumer protection if we did not allow wide legacy use of the synthetic rates, at least in the first



year after the end of panel bank LIBOR – because it would be extremely difficult to distinguish with certainty specific classes, categories, types or other subsets of legacy contracts that could be amended within the time available.

- 3.51** The single identifiable group of contracts that we considered did not require permission to use the synthetic LIBOR settings was cleared derivatives. These contracts did not need to use synthetic settings because clearing houses could use standardised mechanisms to move them to relevant overnight RFRs. They were also a specific subset of contracts that could be easily and clearly delineated.
- 3.52** We concluded that there were few obstacles to the amendment of uncleared derivatives, because they had mechanisms to transition away – notably by means of adherence to the ISDA Protocol. The high take-up of the ISDA Protocol meant that only a small number and value of uncleared derivatives would not have transitioned away by the time synthetic LIBOR settings were published. Given this, we considered that it was neither wise nor necessary to undertake the complex task of attempting to differentiate between uncleared derivatives with structural or explicit links to other LIBOR use, and other uncleared derivatives, in order to permit use by the first group but not the second.
- 3.53** Our considerations are set out in full in paragraphs 3.4 to 3.69 of our September 2021 consultation.

### **Use of synthetic US dollar LIBOR settings**

- 3.54** Our June consultation did not ask respondents to comment specifically on the scope of permitted use of a synthetic rate. However, some respondents expressed views on how we should exercise our legacy use power. These responses have been taken into account as part of the information referred to at 3.47 above.
- 3.55** In terms of the availability of appropriate alternative rates, the mechanisms for, and obstacles and challenges to, transitioning away from LIBOR, or other circumstances, we have identified many similarities but also a few differences between the contracts that referenced sterling and yen LIBOR settings and those that reference US dollar LIBOR settings.

### ***The LIBOR Act and synthetic LIBOR/our legacy use power***

- 3.56** The main difference we have identified is the prevalence in bonds, governed by US law, of the requirement for 100% of bond holders to consent to any amendment to contract terms. This adds extra challenge to conducting successful consent solicitation exercises.
- 3.57** However, as we set out at 3.2 above, the US' LIBOR Act provides a mechanism for contracts governed by US law to transition away from LIBOR to appropriate alternative rates when the US dollar LIBOR panel ends (and thus the relevant LIBOR setting either ceases or becomes unrepresentative), if they do not contain clear, workable fallback provisions. Many legacy bonds fall back to the last available fixing of LIBOR. Under the LIBOR Act, this fallback provision would be disregarded – so the transition mechanism within the Act would apply. Therefore, it should not be necessary for bonds governed by US law to be amended in order to transition away when the US dollar LIBOR panel ends (but see 3.59 below).

- 3.58** A further difference, or at least a consideration, is the interaction of the LIBOR Act with synthetic LIBOR settings, given the importance of international consistency. The LIBOR Act generally aims to steer contracts away from LIBOR if it becomes unrepresentative. As we note at 1.7 above, synthetic LIBOR settings are permanently unrepresentative.
- 3.59** As 8 respondents to our consultation highlighted, and as is set out in the ARRC's LIBOR Legacy Playbook, contracts governed by US law that contain workable non-LIBOR fallbacks are generally not affected by the LIBOR Act. If, under the contractual terms, these fallbacks are only triggered by LIBOR's cessation, then these contracts might use a synthetic US dollar LIBOR setting for as long as such a setting were to be published. They would only move to their intended fallback rate under the contract when the synthetic setting ceases. We call these 'non-covered contracts'.
- 3.60** Three respondents considered this to be an undesirable outcome, mainly because of the risk of potential litigation challenging the appropriateness of using a synthetic setting (given the unrepresentative nature of synthetic settings and that contract parties may not have envisaged the existence of such a rate when the contracts were drafted). These respondents asked that the FCA restrict the use of any synthetic rate to use in contracts governed by non-US law only. Three further respondents remarked or implied that there could be complications or uncertainty if synthetic US dollar LIBOR settings could be used in these contracts.
- 3.61** By contrast, 1 respondent called for synthetic settings to be available for both non-US and US law governed contracts, because they argued that many of these non-covered contracts would fall back to the prime rate and they considered this an undesirable outcome for borrowers.
- 3.62** The restriction on the use of synthetic LIBOR settings only applies to contracts that are within scope of the BMR. It is unlikely (though not entirely impossible) that contracts governed by US law will fall into this category. The scope of the BMR is determined not by jurisdiction but by the type of contract and whether one or more party to the contract is a 'supervised entity' as defined in the BMR. It is for the relevant parties to determine whether their contracts are within scope.
- 3.63** As suggested in the ARRC's LIBOR Legacy Playbook, parties to contracts referencing US dollar LIBOR should inspect their contracts to determine the governing law, the type of fallback (if any) in the contract, and the trigger for the contract to move to the fallback, in order to then determine the replacement rate to which the contract will move and the point at which it will do so.
- 3.64** We think that a restriction on the use of synthetic US dollar LIBOR settings by contracts governed by US law would add extra complexity – as well as the risk that some contracts could face legal uncertainty and the potential for litigation.
- 3.65** Parties to contracts would be required to determine whether they are a supervised entity (see paragraph 3.62 above) and whether the contract is within scope of the BMR, as a restriction would only apply where the contract is within scope. Some parties to contracts found to be within scope might not be permitted to use synthetic LIBOR, but LIBOR would continue to be published – which could result in legal uncertainty. For parties to contracts not within scope of the BMR, there could be ambiguity or dispute about whether the FCA restriction was binding or not.

**3.66** Based on the above, we think this additional complexity and potential uncertainty for contracts governed by US law would be unhelpful for market participants. Further, the proposed methodology for a synthetic form of US dollar LIBOR set out at paragraphs 3.45 and 3.46 provides in our view a fair and reasonable approximation of US dollar LIBOR's likely economic outcome, and one that is consistent with the replacement rates recommended by the FRB in its proposed rule to implement the LIBOR Act for non-derivatives contracts that do not have workable fallbacks.

### ***Other consultation responses relevant to our legacy use power***

**3.67** Ten respondents (including 4 trade associations) asked for a broad use permission, similar to that which we permitted for synthetic sterling and yen LIBOR. Reasons given included minimising any legal and practical uncertainty and confusion for market participants, as well as repeating the successful experience of the sterling and yen transition. On the other hand, 1 respondent expressed concern that allowing too wide an application of synthetic US dollar LIBOR might slow down transition.

**3.68** As set out in paragraphs 3.50 to 3.53, we believe that all asset classes except cleared derivatives will benefit from additional time to transition following the cessation of US dollar panel bank LIBOR. We also agree with the respondents who argued that attempting to distinguish between various classes and categories of legacy contracts could introduce confusion and lack of legal certainty for market participants. We have concluded that we should follow the same approach for US dollar LIBOR settings as for sterling and yen LIBOR settings, in line with our policy framework.

**3.69** With regard to incentives for market participants to pursue active transition, we think the most important incentive is the clarity we have provided that synthetic LIBOR would only be temporary.

### **Our proposed approach**

**3.70** We propose to permit legacy use of any synthetic US dollar LIBOR settings in all contracts except cleared derivatives (whether directly or indirectly cleared).

**3.71** We do not propose to apply any limitations or conditionality to the above permissions, initially at least.

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

**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?**

## 4 Feedback on synthetic sterling LIBOR

### Responses to our consultation

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- 4.1** We received a total of 51 responses from within and outside the UK relating to sterling LIBOR settings (although not all respondents answered all of our questions). The majority of respondents were financial institutions, including wholesale investment banks, retail banks, asset managers and building societies.
- 4.2** Thirty-five of 49 respondents supported our proposal to cease 1-month sterling LIBOR at end-March 2023. Seven respondents were neutral; 5 did not provide a clear answer; and 2 expressed contrary views.
- 4.3** Thirty-one of 48 respondents supported our proposal to cease 6-month sterling LIBOR at end-March 2023. Six respondents were neutral; 7 did not provide a clear answer; and 4 expressed contrary views.
- 4.4** We asked for views on when 3-month synthetic sterling LIBOR could cease in an orderly fashion (Question 4 in our consultation). Nineteen of 46 respondents said at or before end-March 2024 (3 noted benefits from aligning cessation with the end of US dollar LIBOR settings). Eighteen respondents either expressed no specific view on the timing of cessation, or simply said that publication needed to continue beyond 2023. Seven respondents considered that publication should continue for a significant period, and 2 said that publication should only cease in conjunction with provision of an alternative solution such as legislation, because they considered that some contracts face insurmountable barriers to transition.

### Mortgages

- 4.5** Several respondents noted outstanding retail mortgages still linked to 1- and 3-month sterling LIBOR. For the 1-month sterling LIBOR setting, respondents acknowledged that the remaining exposures do not present an insurmountable obstacle to ceasing the setting at end-March 2023. However, respondents said that outstanding consumer exposures to 3-month sterling LIBOR are more substantial. Lenders highlighted difficulties in engaging with retail borrowers, although progress is being made by some respondents, and 1 respondent suggested that setting a cessation date for the 3-month setting would provide impetus for further transition efforts. Three respondents expressed concern that some mortgage-related exposures to the 3-month sterling LIBOR setting – within and outside the UK – will be unable to cope with cessation.

### Private Finance Initiative (PFI) loans

- 4.6** Some respondents noted difficulties in transitioning PFI exposures from sterling LIBOR settings, suggesting there is sometimes reluctance by parties, including local authorities, to engage and consent. Two respondents suggested that their PFI-related exposures to the 6-month setting would be unable to cope with cessation regardless of the time available.

## Bonds and securitisations

- 4.7** Several respondents noted the lack of certainty that counterparties will cooperate with transition; a few considered this lack of certainty to be a reason for us to require continued publication of synthetic settings. Some respondents noted that it may not be possible to launch consent solicitation processes for bonds where sanctions legislation may impact the issuer's ability to seek investors' consent; and some noted that there could be practical challenges for any outstanding bonds with 'dealer poll' fallbacks. With regard to securitisations and other similarly complex transactions, respondents made a variety of arguments: noteholders of linked tranches may not cooperate; 'orphan' transactions have no interested party to organise or fund consent solicitation; and insolvent parties cannot participate.
- 4.8** One respondent argued that the potential for outstanding bond exposures at end-March 2023 meant continued publication of the 1- and 6-month synthetic settings beyond this date may be required. A few respondents said that some outstanding bond exposures to either 3- or 6-month sterling LIBOR settings will be unable to cope with cessation regardless of the time available.

## Our Response

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- 4.9** Based on the information available to us regarding the 1- and 6-month sterling LIBOR settings, including the consultation responses received, we consider that most contracts will be able to transition by end-March 2023. For the 3-month sterling LIBOR setting, again taking account of the information and feedback available, we think that the vast majority of contracts will likely be able to transition to alternative appropriate rates by end-March 2024.
- 4.10** Our power under Article 21(3) of the BMR allows us to compel continued publication so that LIBOR settings can cease in an orderly fashion. We acknowledge the risk highlighted by some respondents that a small number of contracts may not be remediated within the respective timelines for the 3 sterling LIBOR settings. However, we consider that it is possible for cessation to be orderly even if not every contract has transitioned away or been equipped with a workable fallback. Disorderly cessation would involve a sufficient scale of un-remediated contracts to pose a threat to market integrity or to an appropriate degree of protection for consumers. We have not seen evidence that the scale or nature of the contracts remaining after the cessation dates indicated at paragraph 4.9 above for the respective synthetic sterling LIBOR settings would cause significant market disruption or consumer harm. Therefore, we consider that these synthetic settings can cease in an orderly fashion on these dates.
- 4.11** Parties to commercial contracts must work out between them whether they can reach agreement on an amendment to the terms of the contract or whether there is preference to retain the existing contract provisions. For parties that wish to allow their contracts to continue to operate on the same economic terms as synthetic LIBOR, this option is potentially available to these parties by them adding together the relevant term SONIA rate with the ISDA fixed spread adjustment.

## Mortgages

- 4.12** The evidence available from the responses appears to support our view that there are very few mortgages remaining that reference 1-month sterling LIBOR, but confirms there are still a number of mortgages referencing the 3-month setting. We acknowledge the difficulties some lenders have encountered in engaging with borrowers. However, we do not consider it necessary or proportionate to treat these mortgages as irresolvable. Lenders can look for routes by which they can move borrowers to an alternative rate that is clearly and transparently fair to the borrower. The provision and use of the synthetic rates since January 2022 provide lenders with an established alternative formula which they could potentially replicate to create a replacement rate, ensuring continuation of the same economic outcome, should they wish. We agree with the respondent who suggested that a clear cessation date is helpful for outstanding mortgage exposures: we think that providing this clarity will encourage lenders to take proactive steps to transition (and this is consistent with broader feedback from industry in relation to transition more generally).
- 4.13** Moreover, a significant number of mortgages appear to have provisions for moving to an alternative rate when the relevant sterling LIBOR setting ceases. As we said at 3.20 above in relation to US dollar LIBOR, we must balance the interests of borrowers without fallbacks against those of borrowers whose contracts contain fallbacks that will be triggered by the cessation of the relevant sterling LIBOR rate; and also those of LIBOR's administrator IBA, which is being required to continue to publish LIBOR in an unrepresentative form.

## PFI loans

- 4.14** The Infrastructure and Projects Authority (IPA) has issued [guidance](#) to support local authorities in navigating the LIBOR transition process for PFI-related exposures. We did not receive compelling evidence from respondents that local authorities need longer than the time we are providing to consider and consent to any necessary changes.

## Bonds and securitisations

- 4.15** With regard to sanctions legislation, we have engaged with some of the relevant respondents and have been advised that the primary area likely to be impacted is a subset of fixed rate corporate debt. We consider it unlikely that sufficient contracts referencing sterling LIBOR will be impacted to pose a threat to the orderly cessation of the synthetic sterling LIBOR settings.
- 4.16** We have stated in the past that we will not put regulatory pressure on firms to respond to dealer polls and have provided suggestions as to how firms could help streamline the process. We do not regard the existence of dealer poll provisions as an obstacle to transition.
- 4.17** For securitisations and other complex transactions, we understand that often there will be a party connected to an 'orphan' securitisation who, whilst not obliged to act, has an incentive to step in to organise and fund a consent solicitation exercise to facilitate transition. Therefore, we do not think it certain that all orphan securitisations will fail to transition.

- 4.18** In our June consultation, we acknowledged the risk that noteholders of tranches that are not linked to LIBOR may not engage in consent solicitation, which may prevent certain transactions from transitioning. However, all tranches are interlinked and noteholders are rarely 'bystanders' – they are generally potentially impacted by cessation. The nature of the impact will differ according to the contract terms and circumstances, but this is not wholly different from the situation with bonds – and other contracts – more generally. As we say at 4.11 above, it is for parties to contracts to reach agreement on amendments – the failure of a subset of parties to do so is not a justification for intervention.
- 4.19** It is not clear to us why insolvency should always be a barrier to transition, as we understand there would be a party representing the interests of creditors in such an instance, who could act.
- 4.20** Overall, we think that the volume of securitisation contracts that are unable to transition due to these reasons is unlikely to be sufficient to mean that a cessation of any of the synthetic sterling rates will cause widespread disorder in financial markets.

## Annex 1

### Questions in this paper

- 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?
- Q2:** Do you agree with the manner in which we propose to exercise our methodology change power?
- 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?
- Q4:** Do you agree with the manner in which we propose to exercise our legacy use power?
- 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?



## Annex 2

# List of nonconfidential respondents to CP22/11

Banco Santander, S.A. London Branch

Commonwealth Bank of Australia

Credit Suisse

Deutsche Bank AG

ICMA

ING Bank NV

Natwest Bank Plc

Norton Rose Fulbright

RBC

SMBC Bank International plc

Standard Chartered Bank

Sumitomo Mitsui Trust Bank, Limited (London Branch)

The Investment Association (The IA)

UBS AG

West Bromwich Building Society

## Annex 3

### Abbreviations used in this paper

Abbreviation	Description
<b>ARRC</b>	Alternative Reference Rates Committee
<b>BMR</b>	Benchmarks Regulation
<b>CME</b>	CME Group Benchmark Administration Limited
<b>FRB</b>	Federal Reserve Board
<b>FSB</b>	Financial Stability Board
<b>IBA</b>	ICE Benchmark Administration Limited
<b>IPA</b>	Infrastructure and Projects Authority
<b>IOSCO</b>	International Organization of Securities Commissions
<b>ISDA</b>	International Swaps and Derivatives Association
<b>OIS</b>	Overnight Index Swaps
<b>PFI</b>	Private finance initiative
<b>RFR</b>	Risk-free rate
<b>SOFR</b>	Secured Overnight Financing Rate
<b>SONIA</b>	Sterling Overnight Index Average
<b>TONA</b>	Tokyo Overnight Average Rate
<b>TORF</b>	Tokyo Term Risk Free Rate

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

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