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FCA Publishes Speech on Firms’ Progress To Transition From LIBOR to Alternative Risk-Free Rates

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On February 21, the UK Financial Conduct Authority (FCA) published a speech by Megan Butler, the executive director of supervision—Investment, Wholesale and Specialists at the FCA, on firms’ progress in transitioning from the London Interbank Offered Rate (LIBOR) to overnight risk-free rates (RFRs).

The FCA and the UK Prudential Regulation Authority (PRA) are in the process of analyzing firms’ responses to their Dear CEO letter in which they requested a comprehensive assessment of the potential prudential and conduct impacts associated with the LIBOR transition being carried out (as reported in the September 28, 2018 edition of Corporate and Financial Weekly Digest).

The FCA and PRA’s initial observations are that UK banks and insurers are at different stages of being prepared for the transition. Although the FCA and PRA noted that most firms have provided good evidence about their transition work, some firms did not hold their first transition leadership meetings until after receiving the Dear CEO letter. The rate of transition has also been lower on the buy-side than on the sell-side. In the derivatives markets, the FCA believes that some of the reasons they have heard for the delay in moving to alternative RFRs are not justifiable, such as waiting for liquidity to develop, waiting for term rates to be produced based on new overnight RFRs and dealing costs.

The FCA, therefore, encourages asset managers to:

1. Conduct due diligence to identify their LIBOR exposures, including hedging strategies using LIBOR-referencing interest rate derivatives, and investments in bonds or other securities in which interest payments refer to LIBOR;

2. Transition their hedges and positions to the Sterling Overnight Index Average reference rate (SONIA) before LIBOR disappears and before liquidity in LIBOR derivatives begins to decline; and

3. Plan for LIBOR to discontinue at the end of 2021 across all of its tenors and currencies, and review or re-paper contracts. Firms can adopt different approaches to this as the FCA has not prescribed a specific approach.

The FCA’s speech is available here.

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