25 June 2020

Dear Scott, Dear Katherine,

Pursuant to ISDA’s important work on finalising its protocol and other fallback documents, and discussions within the ISDA Board, you asked if the FCA could clarify some further questions on how cessation and loss of representativeness of LIBOR could interact. I hope the information below answers those questions.

As we have said previously\(^1\) we view loss of representativeness as an irreversible step towards the end of panel bank LIBOR. We have also set out why market participants should not assume that any period of non-representative LIBOR based on reduced panel bank submissions would last for more than a short period (i.e., a period of months, not years).\(^2\) Our view on both matters is unchanged.

We welcome the strong consensus across markets on the need to be prepared for the loss of representativeness, as well as cessation, scenarios, and to move away from LIBOR where possible on the loss of representativeness.

While these may not be the most likely scenarios, the ISDA team has correctly pointed out that the contractual language also needs to be robust to deal with the possibility that a pre-announced cessation date has to be brought forward (for example, because the administrator cannot maintain LIBOR for as long as it intended), or a pre-announced date on which representativeness is lost has to be brought forward (for example, because some panel banks decide to leave earlier than others which had previously announced their departure).

Another variant is that a future cessation date is announced, but representativeness is lost \textit{before} that date is reached, so that the already expected cessation is preceded by loss of representativeness (i.e. cessation is announced \textit{before} loss of representativeness is announced).

In the FCA’s view, the triggers and actions suggested in ISDA’s two consultations would work in a robust way if operated consistently with the consultation responses in the following way:

\(^1\) [https://www.fca.org.uk/news/speeches/next-steps-transition-libor](https://www.fca.org.uk/news/speeches/next-steps-transition-libor)

• In line with the consultation responses in relation to cessation, on the announcement of cessation, the credit spread would be calculated upon that announcement, and would be applied to the compounded RFR from the point of cessation.

• In line with the consultation responses in relation to pre-cessation, on the announcement of a date on which representativeness will be lost, the credit spread would be calculated upon that announcement, and would be applied to the compounded RFR from the point of non-representativeness.

It follows that the credit spread would be calculated on whichever of the events (cessation or pre-cessation) is announced first, and would not be recalculated thereafter.

Given the imperative for fallbacks to operate from the point of cessation, and the market’s strong and, in our view, sensible preference that they also operate from the point that representativeness is lost, it follows that the fallback rates should apply from whichever of these two events (cessation or loss of representativeness) occurs first (even if the event is announced subsequent to the original announcement that set the spread). Thus, if loss of representativeness occurs before cessation, the fallbacks would kick in from loss of representativeness. If either cessation or loss of representativeness occurred earlier than initially expected, the fallback would also need to apply earlier. This would meet the market preference, and be consistent with the consultation responses, which look to the pre-cessation trigger to ensure that market participants are not left with contracts using a non-representative rate, given the variety of legal risks and hedging problems this would create.

We discussed the operation of the triggers in the OSG’s sub-group 1, with which ISDA has been discussing fallback issues, and the above was the common understanding of the sub-group.

We reiterate that while we cannot be certain that the date a rate actually becomes unrepresentative would be knowable far in advance, it should not be a complete surprise because of minimum time periods set out in the Regulation.3 We see many advantages in market participants receiving good notice of cessation or pre-cessation events, and will work to help achieve that result where we can.

Finally, you will have seen the 23 June announcements from Her Majesty’s Treasury and the FCA on plans to enhance the FCA’s power to require the administrator of LIBOR to change the methodology by which the rate is produced in certain circumstances, if doing so would protect consumers and market integrity. These changes do not in any way diminish the importance of wide adoption of ISDA’s planned protocol. As the statements make clear, it may not be possible to use the powers for all LIBOR currencies or in all circumstances, notably if inputs necessary to support a methodology are not available.

Further, even where a methodology change required by the FCA is possible and supportive of consumers and market integrity, it would not give contractual counterparties the control over the economic terms of the contract that voluntary transition will provide. While possible methodology changes considered by the FCA would be based on the RFRs, a LIBOR methodology change of this type could not deliver the smooth transition to realised overnight rates compounded in arrears that is market participants’ and authorities’ preference for derivatives markets. The FCA’s statement also noted that it would be necessary to capture in any such

methodology change the expected difference between LIBOR and relevant RFRs, and, for this purpose, the FCA would look to the consensus already established, in large part due to ISDA’s work, in international markets on a way of calculating an additional fixed credit spread. A major benefit of such an approach would be to reduce risk of divergence between published LIBOR values and the value of fallbacks that come into effect in line with ISDA and others’ documentation during a pre-cessation period.

Yours sincerely,

Edwin Schooling Latter
Director
Markets and Wholesale Policy
Financial Conduct Authority