

FCA confirms rules for legacy use of synthetic LIBOR rates and no new use of US dollar LIBOR

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The FCA has confirmed it will allow the temporary use of 'synthetic' sterling and yen LIBOR rates in all legacy LIBOR contracts, other than cleared derivatives, that have not been changed at or ahead of end-31 December 2021.

Article 23C Benchmarks Regulation – Draft notice of permitted legacy use by supervised entities.

These synthetic rates will not be available for use in any new contracts.

LIBOR is currently based on submissions provided by a panel of banks. These submissions are mostly based on estimates intended to reflect the interest rate at which banks could borrow money on unsecured terms in wholesale markets.

Many contracts that use LIBOR have already been switched to new risk-free overnight interest rate benchmarks or will do so at end-2021.

But there is a risk of disruption to markets and consumers if interest payments in LIBOR loans, mortgages, bonds, and other contracts that have not switched by end-2021, cannot be calculated. As a result, the FCA is requiring the publication of 1-, 3-, and 6-month LIBOR rates for sterling and Japanese yen on a synthetic basis until the end of 2022, to allow more time to complete transition.

The FCA announced on 29 September 2021 its decision on a fair, transparent and appropriate way of calculating synthetic LIBOR, approximating what LIBOR might have been in the future. The method is robust against manipulation and was supported by a large majority of respondents as set out in the feedback statement published today.

The FCA has told lenders who are replacing LIBOR with an alternative rate in their contracts, especially those related to mortgages, to treat their customers fairly. They should communicate with borrowers in good time and ensure they are able to consider all options in advance of LIBOR becoming unavailable.

Although 5 US dollar LIBOR settings will continue to be calculated by panel bank submission until end-June 2023, the FCA has also confirmed that the use of US dollar LIBOR will not be allowed in most new contracts written after 31 December 2021. The move to end the use of US dollar LIBOR in new contracts is supported by regulators in the US and around the world. The FCA has provided clarification to help firms implement this restriction.

Edwin Schooling Latter, Director of Markets and Wholesale Policy, commented: 'Today's publications form some of the final building blocks in the transition from LIBOR, a global effort led by the FCA and the Bank of England in conjunction with industry and overseas regulators. But work should not stop here. While synthetic LIBOR reduces risk in the transition and provides a bridge to Risk-Free Rates like SONIA, it will not last indefinitely and contracts need to be moved away from LIBOR wherever possible.'

Notes to editors

1. The FCA will shortly publish a detailed Feedback Statement on responses received to its consultation on the 'use' of LIBOR after end-2021.
2. Our expectations of firms when replacing LIBOR can be found in the FCA's LIBOR conduct Q&A.
3. Updated Q&A for LIBOR mortgage borrowers on what synthetic LIBOR means for them.
4. Under Annex IV of the Benchmarks Regulation (BMR), the FCA has the power to modify the BMR to make it appropriate for the provision of LIBOR under a 'synthetic' methodology.
5. The methodology for calculating synthetic LIBOR is consistent with arrangements widely adopted voluntarily in many market participants' transition arrangements, and endorsed by international authorities. The methodology fixes the term credit and liquidity premium in LIBOR at the median average of its actual value between 2016 and 2021.