BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

FCA FINANCIAL CONDUCT AUTHORITY

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Dear CEO

Firms' preparations for transition from LIBOR to risk-free rates

1. The Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) are writing to the CEOs of large banks and insurance companies[1] regarding the ongoing global benchmark reform effort mandated by the Financial Stability Board (FSB), specifically the transition from LIBOR to alternative rates. As you know, this effort is driven in the UK by the Financial Policy Committee (FPC), the Bank of England (Bank), and the FCA. **The purpose of this letter is to seek assurance that firms' senior managers and boards understand the risks associated with this transition and are taking appropriate action now so that your firm can transition to alternative rates ahead of end-2021**.
2. Since 2014 the UK authorities and market participants have been working jointly through the Working Group on Sterling Risk-Free Reference Rates to pursue the use of more robust interest rate benchmarks by laying the groundwork for a successful market-led transition away from GBP LIBOR.
3. While improvements have been made to LIBOR since April 2013, in the interests of financial stability and market integrity it is important that participants transition away from LIBOR and towards alternatives.[2]
4. Both the FCA and FPC noted in 2017 that it had become increasingly apparent that the absence of active underlying markets and the scarcity of term unsecured deposit transactions raised serious questions about the future sustainability of LIBOR benchmarks. This, in the context of the scale of contracts using LIBOR as a reference rate, and uncertainty about the legal position of such contracts if LIBOR became unavailable, led the FPC to judge that continued reliance of financial markets on term LIBOR benchmarks created a risk to financial stability.
5. That message was emphasised again in the FPC's June 2018 Financial Stability Report,[3] which concluded that the medium-term risks can be reduced only through a transition away from reliance on LIBOR.
6. The FCA and contributor banks have worked to secure voluntary panel bank support to sustain LIBOR until the end of 2021. However, as Andrew Bailey mentioned in his July 2018 speech,[4] firms should treat a LIBOR discontinuation event 'as something that will happen and which they must be prepared for'.
7. As you will be aware, the extent to which LIBOR is deeply embedded in current business practices means transition will be complex and will take time. However, insufficient preparations for transition to alternative rates could have a negative impact on the safety and soundness of firms and cause harm to their clients and to the markets in which they operate.

[1] For the purposes of this letter, references to 'banks' also includes relevant building societies and relevant designated investment firms. Firms which have not received a direct email from their supervision team linking to this letter are not within scope.
[2] www.fsb.org/wp-content/uploads/P101017.pdf.
[3] www.bankofengland.co.uk/financial-stability-report/2018/june-2018.
[4] www.fca.org.uk/news/speeches/interest-rate-benchmark-reform-transition-world-without-libor.

8. The Bank and FCA are grateful to firms for their engagement to date in the market-led transition effort. Market-led working groups in LIBOR currency jurisdictions have already been convened to identify potential preferred alternative risk-free rates (RFRs). The RFRs identified are robust overnight rates, firmly grounded in transactions. For instance, in the UK the Working Group on Sterling Risk-Free Reference Rates recommended SONIA,[5] as its preferred RFR. The Bank of England implemented reforms aimed at strengthening SONIA on 23 April 2018. RFRs have been identified in other LIBOR currency jurisdictions.[6]

9. In addition we note that market-led efforts - co-ordinated through the Working Group on Sterling Risk-Free Reference Rates and other working groups and forums in the UK and elsewhere - have achieved good progress in a number of areas, most notably the recently published Term SONIA Reference Rate consultation[7] in the UK, and the International Swaps and Derivatives Association's (ISDA) consultation on fallbacks to IBORs.[8]

10. Your continued participation and commitment – together with other market participants – to develop new market structures, new technologies, and standards and solutions to address the various challenges during this transition will be an essential part of the success of this collective effort.

11. **In response to this letter, we request by Friday 14 December:**
    i. **a board-approved summary of your firms' assessment of key risks relating to LIBOR discontinuation and details of actions you plan to take to mitigate those risks**. Assessments and plans should consider an appropriately wide range of scenarios and impacts and include a quantification of LIBOR exposures; and
    ii. that you identify the Senior Manager(s) within your firm who will oversee the provision of your response to this letter and the implementation of its transition plans.

12. We recognise that for insurers, Solvency II requires insurers to discount liabilities using risk-free rate curves that are in many currencies currently derived from LIBOR. Monitoring of LIBOR transition has been added as a topic to the European Insurance and Occupational Pension Authority's (EIOPA) general work on insurance RFRs. Firms should understand the risks from LIBOR transition and any dependencies on Solvency II requirements, including in relation to EIOPA's work.

13. Please send your full response to Markets-RFRTransitionTeam@bankofengland.gsi.gov.uk and copied to your PRA and FCA supervision teams. Should you have any questions please contact your PRA and FCA supervision teams.

14. We will review these responses and consider appropriate next steps, and they will also supplement the FPC's monitoring of the risks associated with LIBOR discontinuation and transition.

Yours sincerely

David Rule　　　　Megan Butler　　　　Jonathan Davidson

[5] For more information on the Working Group, see www.bankofengland.co.uk/markets/transition-to-sterling-risk-free-rates-from-LIBOR.
[6] SOFR has been identified as the preferred RFR for US Dollar markets (www.newyorkfed.org/arrc), ESTER as the Euro RFR (www.ecb.europa.eu/paym/initiatives/interest_rate_benchmarks/WG_euro_risk-free_rates/html/index.en.html), SARON as the Swiss Franc RFR (www.snb.ch/en/ifor/finmkt/fnmkt_benchm/id/finmkt_reformrates) and TONAR as the Japanese Yen RFR (www.boj.or.jp/en/paym/market/sg/index.htm/). Firms should also be aware of the recent announcement made by European Money Markets Institute MI regarding the future of EONIA: www.emmi-benchmarks.eu/assets/files/D0030D-2018-Eonia%20review%20state%20of%20play.pdf.
[7] www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/consultation-on-term-sonia-reference-rates.pdf.
[8] www.isda.org/2018/07/12/interbank-offered-rate-ibor-fallbacks-for-2006-isda-definitions.