BANK OF ENGLAND

Speech

Last Orders: Calling Time on LIBOR

Speech given by
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Bank of England “Last Orders: Calling Time on LIBOR” event
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Authorities, internationally, led by Andrew Bailey, have been calling time on Libor for a while. Panel banks have agreed to continue to submit to Libor until end 2021 securing its future until then, but not beyond. This event focusses on the transition to our future without Libor, and the critical point we find ourselves at today – what we refer to in the conference title as 'last orders' for new exposures to Libor.

This is a global issue – affecting multiple currencies. However, as you may expect and consistent with the UK origins of the phrase "last orders", I'm going to choose to focus on sterling Libor and its successor, SONIA, in my remarks today.

First, before turning to that transition, a reminder of why, informed by our recent Dear CEO exercise and with 30 months to go, time is being called on Libor.

Libor prices in fluctuations in the perceived credit quality of banks, whereas for many users, alternative risk free reference rates are better reflections of the general level of interest rates.

Beyond this, although Libor's methodology and governance has been reformed and improved, an underlying issue remains – the way banks fund themselves has changed. There are very few transactions in the markets that Libor purports to measure. Data from the Bank's sterling money market data collection showed that in the first quarter of this year there were on average only 9 deposits a day underpinning 6 month sterling Libor, with a total daily value of £81 million.

This lack of transactions means that panel banks have to use their expert judgement to make their submissions. And this means they have become increasingly uncomfortable about doing so. And if those panel banks stop submitting, there is no Libor benchmark.

Given the pervasive use of Libor historically, this creates a fragility at the heart of markets – that financial markets are reliant upon an unsustainable piece of infrastructure[1]. This financial stability risk is something the Financial Policy Committee has therefore been closely monitoring.[2]

The FCA has secured a breathing space to enable the transition, but only until end-2021. The best way to make the most of the timetable set for Libor to end is for markets to focus on transitioning away from it, to new risk free rates. For sterling markets, to the new risk free rate is SONIA, an overnight benchmark provided by the Bank and underpinned by transactions worth about 40 billion pounds a day.

The need to transition is a critical one for all involved. We impressed this upon firms in our Dear CEO exercise; a key objective of which was to ensure Board level responsibility for transition. And it is key to the

[1] www.bankofengland.co.uk/-/media/boe/files/record/2017/financial-policy-committee-meeting-september-2017.pdf
[2] www.bankofengland.co.uk/financial-stability-report/2018/june-2018

Bank's objectives – risk free rate transition is a core part of the Bank's strategic goal to catalyse reforms in financial markets to make them fairer and more effective.

The good news is, transition is happening. There has been real progress in establishing SONIA as the successor to sterling Libor. In the past 6 months there have been a number of positive developments in the sterling cash market.

From a zero base this time last year, SONIA linked floating rate note ('FRN') issuance now dominates sterling floating rate financials issuance and there is clear momentum towards using the compounded SONIA rate across bond markets. The first 5 months of 2019, have seen 21 different banks, sovereigns, and supranationals issue FRNs referencing compounded SONIA, with a total value of about £19bn.

We've also now seen the first move by a bond issuer to switch their outstanding Libor linked bond to reference compounded SONIA instead. They are currently going through a bondholder Consent Solicitation process, with the deadline next week. This is a development which is being closely watched.

We have also seen the first SONIA linked securitisations issued. In other areas, we are seeing progress. One UK firm has announced it has switched the basis of its balance sheet over to SONIA. And in OTC derivatives, the notional value of cleared SONIA swaps is now only slightly less then cleared Libor referencing swaps, with SONIA starting to dominate at shorter maturities; but this hasn't materially changed over the last six months. SONIA futures as a share of the overall market have increased, but stand at only a small portion of the total.

However, we are yet to see a SONIA based loan. There is also a need for further progress in building required infrastructure, not just to issue, but to hold, value, and risk manage SONIA based instruments. This progress is a positive sign, but the pace of progress needs to accelerate. There is much more to be done.

We have a positive, market-driven plan geared towards finding ways to overcome the barriers to further transition. This is led by the Sterling Risk Free Rate Working Group, whose objective is to catalyse a broad-based transition to using SONIA. The authorities were delighted when Tushar Mozaria agreed to take on the chairing of this[3] and today he will speak about the group's recent initiatives and plan for the rest of the year.[4]

But the efforts of the UK's working group, and those of the others' currency groups, need to be supported by actions at individual firms. If an issue is on the FPC agenda, given they are responsible for the financial

[3] www.bankofengland.co.uk/-/media/boe/files/news/2018/november/boe-and-fca-appoint-new-chair-of-the-sterling-risk-free-reference-rates-working-group.pdf
[4] https://www.bankofengland.co.uk/events/2019/june/last-orders-calling-time-on-libor

system as a whole, then we would generally assume it should also be on the agenda of the senior governance committees of the firms who make up that system. To make sure this was the case, the UK regulators – the PRA and FCA – took a decision to send a “Dear CEO” letter to our largest banks and insurers requesting sight of their Board-approved plans for managing the risks around Libor cessation.

The Bank and FCA have already responded to the individual firms involved and, this morning, we published thematic findings from the exercise. I encourage all Libor users whatever their size and position in the system - to look at this: the emerging themes from the exercise apply to a wide range of firms, not just those who received our letters. I’ll make a few observations:

i. The letter has achieved one of its original objectives of helping to focus senior minds on this topic. Each firm written to now has a dedicated Senior Manager under the Senior Managers regime with responsibility for overseeing the transition – I can see many are here this morning.

ii. The responses to the Dear CEO letter highlighted much of the good work that is already underway; how some firms have mobilised themselves to meet this challenge. But what was surprising was the very different states of readiness for dealing with the transition and associated risks demonstrated by the plans submitted. Supervisors will be working closely with firms on this.

iii. More generally, I only see the level of supervisory engagement on this topic intensifying to make sure firms are ready for end 2021. The response to the Dear CEO letter provides a basis for this engagement to continue. As well as publishing thematic findings, we are following up with each firm individually through the supervisory dialogue.

Having senior focus on achieving an orderly transition is necessary. It is firms’ boards which will allocate the resources needed to get through the work. While we appreciate there are a number of other large projects that firms are currently dealing with, transition from Libor is an issue that needs engagement from the most senior executives and committees in firms.

As such I was pleased to host the first meeting of a new Sterling Senior Advisory Group this morning. Tushar will speak about this group more, but it is the engagement of such senior leaders that will enable us – the authorities and industry – to work through the complex issues and make positive progress.

The Bank is committed to this transition being orderly and managed. Ultimately transition needs to be market led, but will be enabled with the continued coordination and collaboration between the public and private sector. Andrew will speak for the FCA, but speaking for the Bank, I can say we will:

I. Ensure a strong focus on the markets' transition to SONIA through the RFR Working Group and its Senior Advisory Group;

II. Continue and, if needed, intensify supervisory engagement on individual firms' plans and

III. Continue to work together with other authorities internationally through the FSB; this is a global issue.

To conclude, the time for 'last orders' is now. Firms need to be focussed on what they need to do to be able to transact SONIA based products; and stop adding to their post 2021 Libor exposures. There is a growing recognition across market participants of what transition entails. But we need to get the message to all Libor users – firms need to educate their customers.

There is much to welcome in sterling markets but progress needs to accelerate. The developments in the sterling FRN market have demonstrated that change can be rapid once the conditions are right. But firms should not leave it to the last moment, relying on the efforts of others. Firms need to invest in the necessary changes now.