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This letter is historical.
See our supervisory correspondence page
for more information and current views.

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Dear CEO

Asset management firms: prepare now for the end of LIBOR

UK authorities have been clear that the intention is that LIBOR will cease to exist after end-2021. The Financial Policy Committee stated in its Financial Stability Report that **'The continued reliance of global financial markets on Libor poses a risk to financial stability that can only be reduced through a transition to alternative risk-free rates (RFRs) by end-2021.'**

We are writing to all UK regulated asset management firms as we wish to set out our expectations for your firm as it prepares for the end of LIBOR. We expect your firm to take all reasonable steps to ensure the end of LIBOR does not lead to markets being disrupted or harm to consumers, and to support industry initiatives to ensure a smooth transition. Firms, such as yours, in the asset management sector, should be in no doubt that they have a responsibility to facilitate and contribute to an orderly end to LIBOR.

It is essential that you reflect on the points raised in this letter and act as appropriate. LIBOR ending is a market event and the transition to alternatives is market-led. We expect you to take proactive steps now where appropriate and not to wait for instructions from clients. Firms should not expect or base their transition plans on future regulatory relief or guidance or on legislative solutions.

Priorities and milestones

On 16 January 2020 the FCA, the Bank of England and the Working Group on Sterling Risk-Free Reference Rates published documents containing targets for 2020 on LIBOR transition. These documents make it clear that **'firms need to accelerate efforts to ensure they are prepared for LIBOR cessation by end-2021'** and that, **'2020 will be a key year for transition'**.

These targets are intended to support the smooth transition of the industry to alternative rates ahead of end 2021. The targets all have a direct read across for asset management firms, and you should consider how you might usefully adopt them in your firm's LIBOR transition plans. For example:

- *'The FCA and the Bank of England encourage market makers to change the market convention for sterling interest rate swaps from LIBOR to SONIA* … (and) *... have identified 2 March 2020 as an appropriate date for this change to happen.'*
  - ⇨ **Asset management firms are users of swaps on behalf of clients, and so this target implies asset management firms should now consider switching from LIBOR swaps to SONIA swaps for new positions where possible.**

- One of the RFR Working Group's priorities is to '*Cease issuance of GBP LIBOR-based cash products maturing beyond 2021 by end Q3 2020.'*
  - ⇨ **Asset management firms are significant investors on behalf of clients in cash products (such as bonds, securitisations, structured products, loans). Therefore, this target suggests asset management firms should consider not making any new investments in GBP LIBOR based cash products maturing beyond 2021 by end Q3 2020.**
  - ⇨ **Asset management firms also often operate funds and other products which have benchmarks or performance fees linked to LIBOR. So we think this target of end Q3 2020 is sensible for firms to consider when planning to cease launching new products with benchmarks or performance fees linked to LIBOR.**

- Another of the RFR Working Group's priorities is to '*Establish a clear framework to manage transition of legacy LIBOR products, to significantly reduce the stock of GBP LIBOR referencing contracts by Q1 2021.'*
  - ⇨ **This target is directly applicable to asset management firms that have LIBOR exposures or dependencies in the funds they operate, or the instruments they hold on behalf of clients. If your firm has LIBOR exposures or dependencies, but does not have a plan in place, you must act now.**

Products and services

All asset management firms should assume LIBOR will cease after December 2021. If you offer products or services that are exposed to or dependent on LIBOR, you should consider very carefully whether your products and services will meet the needs of clients and perform in the manner expected after 2021. Where firms issue new products with LIBOR exposure beyond 2021, they may need to pay attention to whether such products comply with product governance rules. Example considerations might include whether the use of LIBOR affects whether the charging structure is appropriately transparent or too complex to understand.

Governance and planning

You should ensure all your operational processes are prepared for the transition to alternative rates. LIBOR is embedded in a wide variety of systems and infrastructure used for valuation, measurement and management, and in contractual relationships with clients and with other firms. We expect you to understand how your operations might be vulnerable to LIBOR cessation, and to take appropriate steps to protect your clients, your firm and the markets. Regulated firms retain full responsibility and accountability for discharging all regulatory obligations, regardless of any outsourcing arrangements that may be in place, whether intra-group or to third parties.

If your firm retains material exposures to or dependencies on LIBOR, you should have established a proportionate transition plan agreed by your governing body ('the Board'). If you believe your firm has little or no LIBOR exposures or dependencies, we would expect this view to be tested periodically, with oversight from the Board.

The Board should have oversight of the transition process, and seek support and challenge from second and third lines of defence. Senior managers need to be aware of the risks of LIBOR transition, and firms to be clear about who is accountable for managing each aspect of transition where this is appropriate. Statements of Responsibility should include any responsibilities arising from LIBOR transition plans.

A transition plan should be prepared, including appropriate milestones, resourced adequately and devised holistically, across all relevant business functions. We think a smooth transition from LIBOR is most likely to be achieved if individual regulated firms actively engage with the wider transition efforts in the market. Effective LIBOR transition project plans are likely to recognise any priorities and milestones outlined by the FCA and industry initiatives such as ISDA's work on benchmark fall-back adjustments where appropriate.

The plan should:

- carefully quantify all investments, operations and activities with LIBOR exposures and dependencies for a firm and its clients
- consider both how the firm will remove or ameliorate existing exposures and dependencies in a timely manner and avoid creating new ones and
- include a strategy for keeping clients appropriately informed of such changes as they are developed and implemented

When executing the plan, progress should be monitored to ensure exposures and dependencies diminish at an appropriate rate over time.

Firms' plans should consider the risks arising from LIBOR transition, and identify appropriate mitigation. We have published a Q&A for firms about conduct risk during LIBOR transition. We expect firms to:

- exercise skill, care and diligence
- manage conflicts of interest appropriately
- ensure clients are not misled and are treated fairly and
- act in the best interests of clients

Replacing LIBOR with alternative rates in existing and new products

Your firm might operate funds, collective investment schemes and/or segregated mandates, with objectives and other features that reference LIBOR, such as benchmarks or performance fees. If this is the case, managing transition might involve developing and offering new products that reference alternative rates and amending the constitutional documents of existing products either to include fall-back provisions or to replace LIBOR with alternative rates. You should consider which obligations may be triggered when making changes to product documents, such as requirements to notify us or clients, before the changes are effected.

Investing on clients' behalf

Your firm might invest on behalf of clients in instruments which reference LIBOR such as bonds, loans, swaps and structured products. In this situation, avoiding or managing the risks of LIBOR transition might involve investing in instruments that reference alternative rates or have fall-back provisions, and engaging with issuers and counterparties to convert outstanding instruments to alternative rates or to add fall-back provisions.

Your firm might invest on behalf of clients in third-party funds or segregated mandates that have benchmarks or performance fees, or which hold instruments, that reference LIBOR. In this case, managing the risks of LIBOR transition might involve engaging with third-party managers to switch benchmarks or performance fees to alternative rates or to add fall-back provisions, and ongoing due diligence of third-party managers to ensure holdings in funds and mandates are being transitioned from LIBOR appropriately.

Managing conflicts of interest

Any conflicts of interest arising from LIBOR transition must be mitigated or, where that is not possible, managed appropriately. Firms should prioritise LIBOR transition appropriately and not expose clients to unpredictable or unreasonable costs, losses or risks. When managing the transition of investments held on behalf of clients, firms should ensure all clients are treated fairly and that their interests are upheld throughout. When changing benchmarks, firms should not misrepresent performance, even if inadvertently. When adjusting performance fees, clients should not be disadvantaged.

What you need to do next

If your firm has LIBOR exposures or dependencies, your transition activities should now be underway. If LIBOR transition is not yet underway at your firm, we expect you to take immediate action to develop and to begin to execute an appropriate plan. If your Board decides that no LIBOR transition plan is needed, we may seek to understand and, where appropriate, challenge the reasons for this decision. If, following careful review, your Board decides that a barrier to transition is insurmountable, or your transition preparations will not be completed in time, you should inform us immediately and keep us up to date on developments.

You should continue to monitor the Transition from LIBOR page on our website for updates. If you would like more information, or you need to tell us something, you should speak to your usual supervisor or contact us via the Supervision Hub.

Yours faithfully

Nick Miller
Head of Asset Management Supervision