MFSA MALTA FINANCIAL SERVICES AUTHORITY

Circular

16 November 2021

Circular on the Benchmarks Regulation ('BMR') – Transition from LIBOR to Risk-Free Rates

This circular is being addressed to market participants, particularly those falling within the scope of the Benchmarks Regulation ('BMR'), *inter alia* administrators of benchmarks[1], contributors of benchmarks[2] and users of benchmarks[3].

This circular should be read in conjunction with the Authority's Circular dated 25 March 2021 (the 'Circular'), which Circular brought to the attention of market participants the cessation of the London InterBank Offered Rate ('LIBOR') and the resulting transition to risk-free rates ('RFRs').

1. Background

In July 2017, the Financial Conduct Authority ('FCA') had made public its plans to ensure that LIBOR was maintained until the end of 2021, but not to use its provisions at Law to prolong LIBOR's publication beyond that point. By setting the date beyond which LIBOR will no longer be published as at end of 2021, the FCA gave sufficient time for a complex transition that would need to involve market participants across different markets and jurisdictions.

[1] In terms of Article 3(1)(5) of BMR, provision of a benchmark means; (a) administering the arrangements for determining a benchmark; (b) collecting, analysing or processing input data for the purpose of determining a benchmark; and (c) determining a benchmark through the application of a formula or other method of calculation or by an assessment of input data provided for that purpose.

[2] Pursuant to Article 3(1)(8) of BMR, contribution of input data refers to providing any input data not readily available to an administrator, or to another person for the purposes of passing to an administrator, that is required in connection with the determination of a benchmark and is provided for that purpose.

[3] Article 3(1)(7) of BMR defines use of a benchmark as; (a)issuance of a financial instrument which references an index or a combination of indices; (b) determination of the amount payable under a financial instrument or a financial contract by referencing an index or a combination of indices; (c) being a party to a financial contract which references an index or a combination of indices; (d) providing a borrowing rate as defined in point (j) of Article 3 of Directive 2008/48/EC calculated as a spread or mark-up over an index or a combination of indices and that is solely used as a reference in a financial contract to which the creditor is a party; and (e) measuring the performance of an investment fund through an index or a combination of indices for the purpose of tracking the return of such index or combination of indices, of defining the asset allocation of a portfolio, or of computing the performance fees.

As explained in the Circular, on 05 March 2021, the FCA had announced that:

i. All CHF and EUR LIBOR settings, the 1 Week and 2 Months USD LIBOR settings, and the Overnight/Spot Next, 1 Week, 2 Months and 12 Months GBP and JPY LIBOR settings will **cease immediately after 31 December 2021**; and
ii. The Overnight, and 12-Months US dollar LIBOR settings will **cease immediately after 30 June 2023**.

2. Way Forward

Once the cessation dates for all panel bank LIBOR settings had been set, the industry has entered into the final and critical phase of the transition from LIBOR to RFRs. It is therefore imperative that market participants continue to build on work which should have already been undertaken to date, and in some cases, accelerate efforts to ensure a smooth transition from LIBOR to RFRs.

By way of the Authority's circulars dated 25 March 2021 and 30 July 2021, market participants were urged to come forward and provide data vis-à-vis their exposures to critical benchmarks, including LIBOR. Through the data collected as at 30 June 2021, the MFSA noted that several market participants (including banks, insurance undertakings and asset management firms) had significant exposures to LIBOR. Therefore, the MFSA expects that by now market participants have already determined the specific actions necessary to mitigate the risks to safety and soundness arising from their exposures to LIBOR, thus ensuring good client outcomes whilst preserving market integrity.

The following is a list of areas where it is crucial for market participants to take action to prepare for the cessation of LIBOR:

i. **Systems readiness for LIBOR cessation:** Market participants should ensure that robust systems and processes for the RFR are in place to manage the reliance on fallback post LIBOR cessation. Market participants should also ensure that their risk management function takes full consideration of such resilience.

ii. **Active transition of legacy LIBOR exposures:** Market participants should increase their efforts to carry out plans designed to transition their inventory of LIBOR-linked legacy contracts prior to the confirmed cessation dates of LIBOR, to the extent possible. Contracts which to date still reference LIBOR should be amended in order to (at least) include a contractually robust fallback that is triggered upon the cessation of LIBOR, or preferably an agreed transition into a robust alternative reference rate.

    It is in the interest of market participants to ensure that the pool of contracts referencing LIBOR beyond the confirmed cessation dates are reduced to those contracts that genuinely have no or inappropriate alternatives and those which realistically cannot be amended or renegotiated. The time remaining for the cessation of LIBOR is short, hence actions should promptly be taken to deliver progress on a risk-based approach.

iii. **Conduct risk mitigation:** As transition from LIBOR to RFRs approaches, market participants are expected to augment their efforts to identify and address conduct-related risks. To ensure clients are fairly treated throughout the LIBOR transition, market participants should maintain their customers informed about the LIBOR transition into RFRs and the resulting impact. Information to clients should be promptly made available to allow clients to consider and make informed decisions in relation to products and risks which they are exposed to.

iv. **Development of RFR markets:** Market participants are well aware of the cessation dates for LIBOR panels, accordingly, ensuring markets across RFR products are deep and liquid is crucial for a smooth transition and continuity in the supply of lending and risk management products following the cessation of LIBOR. Market participants should also increase their efforts to carry out their transactions using RFRs, in turn accelerating the development of RFR markets.

v. **Selection of appropriate alternatives to LIBOR:** Market participants should, to the extent possible, use the most robust alternative reference rate to LIBOR. For instance, in the case of sterling settings, the alternative reference rate will generally be SONIA, whereas in the case of euro settings, the Euro Short-Term Rate would typically be the designated alternative reference rate. In choosing benchmarks for use in their products, market participants should consider the relevant industry guidelines published, including the work undertaken by the RFR working groups.

It is essential that market participants carefully consider and reflect on the points raised in this Circular in order to act as appropriate. The MFSA expects all market participants to continue taking proactive steps to ensure a smooth transition from LIBOR to RFRs.

3. Contacts

Should you have any queries relating to the above kindly contact the Authority on benchmarks@mfsa.mt.

We thank you in advance for your cooperation.