LIBOR transition and the derivatives trading obligation

Policy Statement
PS21/13

October 2021

This relates to

Consultation Paper 21/22
which is available on our website at
www.fca.org.uk/publications

Please send any comments
or queries to:

Gabriella Toth / John Wu
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

Telephone:
020 7066 1680 / 0207 066 8720

Email:
cp21-22@fca.org.uk

Moving around this document
Use your browser's bookmarks and tools to navigate.
To **search** on a PC use Ctrl+F or Command+F on MACs.

Sign up for our
news and publications alerts

See all our latest
press releases,
consultations
and speeches.

Contents

1 Summary

1.1 In July 2021, we consulted in CP21/22 on amendments to the list of derivatives subject to the derivatives trading obligation (DTO) in line with Articles 28 and 32 of UK MiFIR (onshored Regulation (EU) No 600/2014 on Markets in Financial Instruments), as further specified under the UK regulatory technical standards (RTS) 4 (onshored Commission Delegated Regulation (EU) 2016/2020).

1.2 The DTO requires that financial and certain non-financial counterparties conclude transactions in standardised and liquid over-the-counter (OTC) derivatives only on regulated trading venues. These venues include regulated markets (RMs), multilateral trading facilities (MTFs), organised trading facilities (OTFs) and third country trading venues considered to be equivalent for the purposes of the DTO (in line with Article 28(1)(d) of UK MiFIR).

1.3 The proposed amendments in CP21/22 reflected changes in the liquidity profile of certain interest rate swaps (IRS) which are subject to the DTO as a result of the interest rate benchmark reform. They also took account of the Bank of England's (Bank) proposal to modify the contracts which are subject to the derivatives clearing obligation (DCO).

1.4 This Policy Statement (PS) sets out our finalised amendments to the UK RTS on the derivatives trading obligation (onshored Commission Delegated Regulation (EU) 2017/2417) exercising the FCA's powers under Article 32(5) of UK MiFIR and section 138P of the Financial Services and Markets Act 2000 (FSMA). The amendments to the RTS will come into force on 20 December 2021.

1.5 Our finalised amendments to the DTO take account of the Bank's changes to the scope of the DCO, our updated liquidity analysis covering the period between January and July 2021, and the responses we received to CP21/22.

1.6 We recognise that the liquidity profile of the derivatives market will continue to evolve as the interest rate benchmark reform unfolds. As a result, we may propose further amendments to the scope of the DTO in due course.

Who this affects

1.7 This PS will affect financial counterparties (such as banks and investment firms) and non-financial counterparties that are, or may become, subject to the DTO. It is also of interest to regulated trading venues, including third country trading venues that are considered equivalent for the purposes of the DTO, and to central counterparties (CCPs).

The wider context of this policy statement

1.8 Article 32 of UK MiFIR sets out the procedure for determining which derivatives are subject to the DTO. This requires establishing that the derivatives are:

- subject to the DCO in line with Article 5 of UK EMIR (onshored Regulation (EU) No 648/2012 on OTC derivatives, CCPs and trade repositories);
- admitted to trading or traded on at least one of the relevant trading venues; and
- sufficiently liquid to trade only on those venues.

If these conditions are satisfied, we can make rules specifying that the class of derivatives should also be subject to the DTO.

1.9 What counts as 'sufficiently liquid' depends on whether the class of derivatives, or a subset thereof, meet the criteria specified in Article 32 of UK MiFIR and UK RTS 4. We are required to amend, suspend or revoke existing RTS if there is a material change in these criteria.

1.10 As CP21/22 explained, we reviewed the DTO because of the interest rate benchmark reform and transition plans to relevant risk-free rates (RFRs); and the consequential changes that the Bank has made to the DCO. They have contributed to the change in the liquidity profile of the derivatives market since the European Securities and Markets Authority's (ESMA) last review in 2017. Accordingly, the Bank has confirmed changes to the DCO in its publication on 29 September 2021.

1.11 On 29 September 2021, we issued a package of LIBOR-related publications. These included a number of decisions on how we use our powers under the Benchmarks Regulation (UK BMR - onshored Benchmark Regulation (EU) 2016/1011) to ensure an orderly wind-down of LIBOR. We confirmed that we will compel LIBOR's administrator to continue publication of the 1-, 3- and 6-month sterling and JPY LIBOR settings under a synthetic methodology after end-2021. We will do so until the benchmark can cease to be provided in an orderly way. New use of these synthetic LIBOR rates will be prohibited, and we consulted on which legacy contracts will be permitted to use them. We will confirm our decision in Q4 of this year.

1.12 While some USD LIBOR settings will continue until mid-2023, they are for use in legacy contracts only. We are consulting on restricting new use of these USD LIBOR settings, in line with US guidance and our own existing supervisory expectations. We have also said we would consider the case for using our powers to require publication of some USD LIBOR settings on a synthetic basis after mid-2023, as transition progresses.

1.13 The classes of derivatives currently in the DTO include products referencing LIBOR benchmarks that will be discontinued or may continue on an unrepresentative basis and become subject to use restrictions under UK BMR. Further, once the transition to RFRs has completed in those markets, the activity in OTC derivatives which the DTO currently covers will be significantly reduced and migrate to new derivative products. If we took no action, this would undermine the 2009 G20 commitment to move trading of standardised OTC derivatives on to trading venues, where appropriate, and the policy objective of the DTO.

1.14 In Chapter 2 of CP21/22, we outlined the various international efforts to transition away from legacy benchmarks as part of the benchmark reform, focusing specifically on those transitionary measures in the context of the DTO.

1.15 Below we give a summary of the relevant transition plans and our proposals in CP21/22.

Table 1: Summary of transition plans and proposals in CP21/22

Benchmark rate	DTO	Transition plans	Relevant RFR	Proposals in CP21/22
GBP LIBOR	IRS that reference to GBP LIBOR with a tenor of 3 and 6 months	Cease to be provided by any administrator or no longer be representative immediately after 31 December 2021. Milestone to stop new GBP LIBOR business that expires after end-2021 and for linear derivatives after end Q1 2021 (except for risk management of existing positions).	Sterling Overnight Index Average (SONIA)	Analysis showed that overnight indexed swaps (OIS) referencing SONIA as a class of OTC derivatives is sufficiently liquid to impose a DTO. To remove derivatives referencing GBP LIBOR under the current DTO and replace them with OIS referencing SONIA. To extend the DTO for SONIA OIS to trade start types spot-starting and IMM (next 2 IMM dates) with tenors of 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 12, 15, 20, 25 and 30 years.
USD LIBOR	IRS that reference to USD LIBOR with a tenor of 3 and 6 months	Cease to be provided by any administrator or no longer representative immediately after 30 June 2023 in the case of the USD tenors included in the DTO. Use of USD LIBOR in new contracts should stop by end-2021 at the latest (some exceptions for risk management transactions). SOFR First initiative - recommendation that on 26 July 2021 and thereafter, interdealer brokers replace trading of LIBOR linear swaps with trading of SOFR linear swaps.	Secured Overnight Financing Rate (SOFR)	Analysis showed that liquidity in OIS referencing SOFR as a class of OTC derivatives is developing while relevant USD LIBOR derivatives continued show sufficient liquidity. Did not yet meet relevant criteria to be sufficiently liquid for the purposes of the DTO. The Bank did not propose any changes to the DCO for USD products and contract types referencing USD LIBOR continue to be subject to the DCO. In absence of a change to clearing mandates, intention to monitor market developments and liquidity in USD LIBOR and SOFR products over the coming months as relevant deadlines and milestones are likely to affect liquidity.
EONIA	Currently not included in the DTO	Administrator of the Euro Overnight Index Average (EONIA) has confirmed that EONIA will be discontinued on 3 January 2022. Conversion of cleared outstanding EONIA OIS into corresponding €STR OIS contracts is expected to take place in October 2021.	Euro short-term rate (€STR)	Analysis showed that OIS referencing €STR did not yet display the same level of liquidity of EURIBOR or other products currently subject to the DTO. Intention to monitor market developments and liquidity in €STR OIS markets over the coming months.

Benchmark rate	DTO	Transition plans	Relevant RFR	Proposals in CP21/22
EURIBOR	IRS that reference to the Euro Interbank Offered Rate (EURIBOR) with a tenor of 3 and 6 months	Reformed.	N/A	Relevant EURIBOR-based swaps continue to be sufficiently liquid. Proposed to maintain them as part of the DTO.

Note

A number of CCPs announced their intention to remove the contract types which reference the benchmarks being discontinued or that may continue on an unrepresentative basis and become subject to use restrictions under UK BMR from the list of contracts that they clear. Outstanding cleared contracts that reference such legacy benchmarks will also be contractually converted to the relevant near RFR contracts, where applicable.

Source: FCA and ICE Benchmark Administration announcements. SOFR First initiative by Commodity Futures Trading Commission's (CFTC) Interest Rate Benchmark Reform Subcommittee. EONIA and EURIBOR updates by the European Money Markets Institute (EMMI).

1.16 As well as the transition plans in Table 1, on 1 July 2021 the Working Group on Euro Risk-Free Rates recommended that interdealer brokers change RFR swap trading conventions from EONIA to €STR from 18 October 2021 (the €STR First initiative). This is in line with the CCP transition plans mentioned in Table 1. The group also supports a second Cross-Currency Swaps Initiative, which recommends a common start date of 21 September 2021 to switch the quoting convention in the inter-dealer market for relevant cross-currency swaps.

1.17 Under Article 32(2) of UK MiFIR a class of derivatives can only be subject to the DTO where they are also subject the DCO. We set out below the changes that the Bank has confirmed to the DCO in its publication on 29 September 2021. In particular, the Bank will implement modifications to the contract types subject to the DCO by:

- removing, on Monday 18 October 2021, the contract type referencing EONIA from the OIS class. The Bank will replace it with the contract type in the OIS class referencing €STR with an original maturity of 7 days to 3 years.
- removing, on Monday 6 December 2021, the contract type referencing JPY LIBOR from the Basis Swaps and Fixed-to-float IRS classes. Derivatives referencing JPY LIBOR are not in scope of the DTO.
- removing, on Monday 20 December 2021, the contract type referencing GBP LIBOR from the Basis Swaps, Fixed-to-float IRS and Forward Rate agreements (FRA) classes. The Bank will replace it with the contract type in the OIS class referencing SONIA but with an amended original maturity range of 7 days to 50 years.

The Bank is also proposing to add, on or shortly after Monday 6 December 2021, the contract type referencing the Tokyo Overnight Average (TONA) with an original maturity of 7 days to 30 years.

1.18 We have worked with the Bank and relevant international authorities to ensure, where appropriate, a coordinated and consistent approach. We know the liquidity profile of the derivatives market will evolve. We will continue to monitor market developments and ensure appropriate engagement with authorities to ensure that the DTO remains appropriately calibrated. This may require us to propose further changes to the DTO in due course.

How it links to our objectives

1.19 CP21/22 explains that the changes set out in this PS support our strategic objective of ensuring that relevant markets function well – in this instance the wholesale market for OTC derivatives and the other markets that depend on them. They also advance our operational objective of protecting financial markets, by ensuring that the most liquid derivatives are traded in a manner which supports market integrity and financial stability.

- **Consumer protection:** The changes we are making have a limited impact on our consumer protection objective. OTC derivatives markets are composed of professional counterparties with generally a good understanding of the risks involved. OTC markets also operate according to rules and practices that are generally well understood by users. We also have a competition duty to promote effective competition when addressing our consumer protection objective, which we have had regard to when finalising our changes set out in this paper. The changes aim to deliver greater and better transparency, allowing users to make more informed decisions about where and how to trade.
- **Market integrity:** In general, trading on trading venues improves transparency, operational efficiency and monitoring against market abuse, all contributing to market integrity. Moving transactions in standardised and liquid OTC derivatives on to regulated trading venues increases the scope for market surveillance to help identify market abuse, and enhances trade transparency. It can contribute to the operational efficiency and resiliency of markets. Transactions executed on trading venues also usually benefit from a robust post-trade infrastructure. The PS also supports a desired key outcome in our 2020/21 FCA Business Plan of an orderly transition from LIBOR.
- **Competition:** As CP21/22 highlights, evidence suggests that well-calibrated requirements to trade on-venue improve liquidity because of increased competition between liquidity providers, which results in lowered execution costs for end-users.

Summary of feedback and our response

1.20 We received 12 responses to CP21/22. Most respondents supported our proposals and were generally positive about our approach.

1.21 Respondents broadly supported our proposal to remove derivatives referencing GBP LIBOR from the current DTO and replace them with OIS referencing SONIA. However, a small number of respondents suggested we delay implementation to enable participants to focus their resources on LIBOR transition preparations for end-2021, and to allow additional clarity to emerge on the approach of overseas authorities towards GBP products. Generally, respondents supported the alignment of our changes to the DTO with CCP conversion dates, and the Bank's modification to the DCO.

1.22 There was overall support for our proposal to continue to monitor market developments and liquidity in USD and EUR products and to coordinate our approach with the Bank and other international authorities, where appropriate, so that timely modifications to the DTO can be made as needed.

1.23 Most respondents agreed with our analysis that OIS referencing SOFR and €STR do not appear to be sufficiently liquid yet for the purposes of the DTO. But they had differing views on when we would need to modify the DTO for USD and EUR products. One respondent disagreed with our proposal not to include classes of derivatives referencing SOFR OIS in scope of the DTO at this time. Two respondents noted that removing IRS referencing USD LIBOR from the scope of the DTO would be justified by end-2021.

1.24 Since we published CP21/22, we have undertaken further analysis to monitor the liquidity profile of the derivatives market covering the period until the end of July 2021. This data-driven exercise was intended to update the analysis we presented in Chapter 4 of CP21/22 and to address the comments raised about USD products.

1.25 Our liquidity analysis continues to support our proposals in CP21/22. It shows that trading activity in SOFR OIS has increased since the beginning of the year but remains a fraction of activity in USD LIBOR and does not yet meet relevant criteria to be sufficiently liquid for the purposes of the DTO.

1.26 Our analysis shows that relevant SONIA trades already significantly outnumber GBP LIBOR trades and we expect this trend to continue during the rest of the year. We have also found that most SONIA products are already voluntarily traded on-venue. Taking account of this and other factors discussed in Chapter 2, including alignment with the Bank's changes to the DCO, we have decided not to amend the date proposed in our consultation paper. Therefore, the amendments to the RTS will come into force on 20 December 2021.

1.27 Consequently, we are implementing the proposals we consulted on in CP21/22. As our final changes do not differ from the proposals included in CP21/22 and the relevant considerations included in our cost benefit analysis (CBA) remain unchanged, we consider that the original CBA remains appropriate.

1.28 We recognise that relevant deadlines and milestones are likely to increase liquidity in SOFR OIS products as the year progresses. Activity in €STR OIS products may also increase with the recent announcement of €STR First mentioned above. So, we will continue to monitor market developments and liquidity in these products and consider making further changes to the scope of the DTO in due course, once we are satisfied that the class of derivatives is sufficiently liquid for inclusion in the DTO.

What we are changing

1.29 We confirm the changes proposed in CP21/22. In particular, our liquidity analysis indicates that SONIA OIS as a class of OTC derivatives is sufficiently liquid to impose a DTO. Further, given relevant deadlines planned for the end of 2021 for GBP LIBOR, we expect liquidity in SONIA swaps to increase further in the course of 2021.

1.30 Therefore, in line with the changes by the Bank, we are removing derivatives referencing GBP LIBOR from the current DTO and replacing them with OIS referencing SONIA. We are applying the DTO for SONIA OIS to trade start types spot-starting and IMM (next 2 IMM dates) with tenors of 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 12, 15, 20, 25 and 30 years.

Outcomes we are seeking

1.31 An appropriately calibrated DTO may improve how OTC derivatives markets function by increasing transparency and encouraging greater competition between liquidity providers. It would enable market participants to trade more easily with multiple counterparties at a lower cost.

1.32 Greater use of regulated trading venues may also increase market resilience due to the use of more robust post-trade market processes.

1.33 Our changes also support the 2009 G20 commitment to move trading of standardised OTC derivatives on to trading venues where appropriate, thereby supporting improved transparency, reducing systemic risk and the threat posed to financial stability.

Measuring success

1.34 The changes we are making to the DTO's scope support one of the key outcomes in our 2020/21 FCA Business Plan of an orderly transition from LIBOR to relevant RFRs. We will measure success against that objective, as well as that of the original G20 mandate. We will consider our policy to be successful where amending the DTO maintains or improves liquidity and transparency in the relevant derivatives included in our amendments. We will continue to review relevant market data on liquidity to ensure the success of our policy outcome.

Equality and diversity considerations

1.35 We have considered the equality and diversity issues that may arise from the changes we are implementing.

1.36 Overall, we do not consider that the changes we are implementing materially impact any of the groups with protected characteristics under the Equality Act 2010.

Next steps

1.37 Paragraph 1.30 above sets out the final changes we are making, which will come into force on 20 December 2021. Our changes to the DTO for contract types referencing GBP LIBOR and SONIA will coincide with the Bank's modification to the DCO, and with the conversion of outstanding LIBOR contracts by UK authorised and recognised CCPs.

1.38 For relevant USD and EUR products, we will continue to monitor market developments on an ongoing basis. We will consider including SOFR and/or €STR OIS products in the DTO where the class of derivatives is sufficiently liquid when assessed against the relevant criteria and, where relevant, the Bank has decided to include that class of derivatives in the DCO.

2 Summary of responses

2.1 We received 12 responses to CP21/22. We include the list of non-confidential respondents in Annex 1.

2.2 We give a summary of the feedback received in Chapter 1 above. Overall, respondents supported our proposal to modify the list of derivatives subject to the DTO in light of the interest rate benchmark reform and the Bank's changes to the scope of the DCO. Respondents also agreed with the benefits that a well-calibrated DTO brings.

2.3 We summarise below the responses we received to each of the questions in CP21/22 and set out our response to these points.

Approach and assumptions

2.4 In Chapter 3 of CP21/22 we set out our approach and assumptions for performing our liquidity analysis and asked questions 1 to 3 below. We give a summary of our approach and assumptions, followed by the responses we received to each of the questions.

Which types of derivatives are being considered?

2.5 For the types of derivatives considered as part of the liquidity analysis we said that:

- Our starting point was to take account of: the set of derivatives currently in scope of the DTO, the Bank's proposals in its May 2021 consultation and the LIBOR transitions plans.
- So, we considered SONIA and €STR OIS contracts (which the Bank proposed to replace relevant EONIA contracts with). Our analysis also considered SOFR OIS contracts given relevant transition deadlines and milestones that were, and still are, likely to affect liquidity in USD products. Our analysis compared those OIS contracts with relevant LIBOR and EURIBOR swaps.
- We did not consider contracts referencing LIBOR in currencies other than GBP and USD, which are also subject to the LIBOR transition but are not part of the current DTO. For example, we did not consider contracts referencing JPY LIBOR or OIS referencing TONA. We note, however, that since we published our consultation, the Bank has announced its proposal to replace contract types referencing JPY LIBOR with OIS referencing TONA in the DCO.
- We considered only the most standardised and liquid OIS contracts using standardised contract specifications (trade start type, tenor, fixed leg payment frequency, fixed leg day count convention, floating leg payment frequency etc). Many of these were the same as those included for IRS contracts currently subject to the DTO. We relied on market intelligence to identify other tenors and trade start types which may be, or become, liquid.
- We did not identify any classes of derivatives or individual derivatives contracts that should be subject to the DTO but for which no CCP has yet received authorisation under UK EMIR, or which are not admitted to trading or traded on a trading venue.

The regulatory framework and data sources

2.6 On the regulatory framework, we set out the criteria that needs to be met for the DTO to apply as required by Article 32 of UK MiFIR and UK RTS 4 (see Annex 3). The criteria include the average frequency and size of trades, the number and types of active market participants and the average size of spreads.

2.7 We used both quantitative and qualitative data from a variety of sources, including from EMIR trade repositories, UK trading venues operating in the inter-dealer and the dealer-to-client markets and public data sources. In some areas, for example on spreads, we could only use publicly available information from ICE Swap Rate and qualitative information provided by trading venues.

Approach

2.8 In line with UK RTS 4, we did not set fixed thresholds for relevant liquidity criteria which would need to be met to determine whether a class of derivatives should be subject to the DTO. However, we assessed liquidity against the derivatives currently in scope of the DTO and had regard to relevant thresholds set out in UK RTS 2 (onshored Commission Delegated Regulation (EU) 2017/583).

2.9 We also considered the totality of liquidity in the relevant swaps. That is, the liquidity of existing DTO products together with the liquidity of swaps that are going to substitute them because of the benchmark reforms.

2.10 Lastly, the criterion on the average frequency of trades requires us to make an assessment over a sufficient period of time to determine whether the liquidity of each class of derivatives, or a relevant subset thereof, is subject to seasonal or structural factors. This was challenging, as the market is still adapting following the UK's withdrawal from the European Union (EU) and the LIBOR transition is not yet complete.

Impact

2.11 We also had to consider the anticipated impact that the DTO might have on the liquidity of a class of derivatives, or a relevant subset thereof, and the commercial activities of end-users which are not financial entities. We said that LIBOR transition plans are public, and arrangements are in place to help manage an orderly wind-down where critical benchmarks are being discontinued or may continue on an unrepresentative basis and become subject to use restrictions under UK BMR. Because of this we expect fewer new long-dated derivatives currently subject to the DTO to be entered into, particularly as we move closer to DTO changes taking effect. Also, we do not expect changes to the classes of derivatives in DTO to slow, hinder or disrupt the LIBOR transition and benchmark reform plans. Including new classes of derivatives that benchmark to RFRs could instead support greater liquidity and the development of forward term rates based on OIS. We also included 2 studies, which found that swaps subject to the US swap execution facility (SEF) trading mandate saw significant improvements in liquidity; and that electronic auction trading was associated with greater liquidity.

> **Q1:** ***Do you agree with the approach and assumptions specified above? If not, please explain why.***

2.12 We received 12 responses to this question. All but 1 respondent agreed with the approach and assumptions outlined in our consultation paper.

2.13 One respondent questioned whether - in the case of the LIBOR transition - a DCO is strictly necessary to establish the set of instruments that can be considered for the DTO. They noted that for products with high voluntary clearing rates (eg SOFR), where there is already a clearing mandate in place within the same currency (eg USD), there is a strong argument for imposing the DTO. They argued that this would foster added transparency and potentially reduce risks to financial stability from off-venue activity.

2.14 However, several other respondents reiterated that the DTO should only apply to a subset of derivatives subject to the DCO for which sufficient liquidity exists. One respondent noted that imposing the DTO (or DCO) too narrowly would not prevent trades being executed on a venue and cleared. This is because market participants often choose to trade on-venue and clear for reasons unrelated to a DTO and DCO. According to the respondent, this can be seen by RFR products already being traded on-venue and cleared where currently no obligations apply.

2.15 On the data sources used in our analysis, 1 respondent cautioned against us overrelying on EMIR trade repository data, and on using data that coincides with a period of market uncertainty and readjustment due to the UK's withdrawal from the EU (ie January to April 2021). The respondent also noted that data from trading venues may not fully represent market activity.

Our response

On whether a DCO is strictly necessary to establish the set of instruments that can be considered for the DTO - Article 32(1)(a) of UK MiFIR only allows us to make RTS specifying which classes of derivatives, or subset thereof, that is subject to the DCO should be subject also to the DTO. We note the concern raised, but the DCO is a precondition for including a class of derivatives in the DTO.

We note the response about data sources and period used. As mentioned in CP21/22, we collected information from a variety of sources, which included publicly available data. Gathering information and market intelligence from multiple sources allowed us to evaluate the different dimensions of current and prospective liquidity, and to ensure that our analysis and conclusions are sufficiently robust. We also noted the challenges from the data period used in CP21/22 and consider that using data covering the period up to the UK's withdrawal from the EU would not be a true reflection of the changes in liquidity in relevant OTC derivatives markets. We have also undertaken additional analysis to the end of July to assist in this respect.

We have not received any feedback that would suggest any necessary changes to our approach and assumptions.

Q2: ***Do you agree with the FCA that there do not appear to be any classes of derivatives or individual derivative contracts that should be subject to the DTO but for which no CCP has yet received authorisation under EMIR or which are not admitted to trading or traded on a trading venue? If not, please explain.***

2.16 We received 12 responses to this question. All respondents agreed with this point.

2.17 Some respondents reiterated the importance of alignment between the DCO and the DTO. One respondent said that, in general, they would not expect any classes of derivatives which are not being both actively cleared at a CCP and traded on a trading venue to be suitable for a DTO.

2.18 One respondent noted that there have been a number of proposed term rates developing in the USD market, and asked that regulators clarify their potential use in OTC derivatives. In particular, the respondent is concerned about an uneven playing field between these term rates and compounded in-arrears RFRs. They felt that if relevant OTC derivatives referencing such term rates are not subject to the DTO (or DCO), this could reduce market transparency and make markets increasingly difficult to monitor.

Our response

On the use of forward-looking term rates, we do not expect their use to become widespread in the derivatives market. The official sector recognises that in some cases there may be a role for RFR-derived term rates, but this must be limited compared with the current use of LIBOR benchmarks in order to ensure financial stability. The Working Group on Sterling Risk-Free Reference Rates and the FICC Markets Standards Board (FMSB) have set out very limited use cases for SONIA term rates, as has the Alternative Reference Rates Committee (ARRC) for SOFR term rates. We expect firms to take account of relevant industry guidelines and recommendations when selecting benchmarks for their products.

However, we would welcome further dialogue with market participants about relevant term rates to assess the issue and to understand how liquidity is developing.

In conclusion, there do not appear to be any classes of derivatives or individual derivative contracts that should be subject to the DTO but for which no CCP has yet received authorisation under EMIR, or which are not admitted to trading or traded on a trading venue.

Q3: ***Do you agree with the FCA's view on impact in paragraphs 3.26 and 3.27 above? If not, please explain why.***

2.19 We received 12 responses generally agreeing with our view on expected impact of the DTO on the liquidity of derivatives and on the commercial activities of end-users which are not financial entities. Most respondents agreed that the inclusion of RFR-based derivatives in scope of the DTO would improve liquidity and reduce execution costs. One respondent added that trading obligations significantly increase the transparency of markets, further aiding end-users and potentially leading to reduced trading costs.

2.20 One respondent noted that transparency was particularly beneficial during the most recent stressed market conditions of March 2020. The respondent used US swap data repositories (SDR) data on vanilla, spot starting 10Y USD fixed-float swaps to calculate daily price dispersion for swaps during H1 2020. Price dispersion was first introduced to them by the Bank in a paper by Benos, Payne and Vasios as a measure of liquidity. The respondent concluded that despite extreme levels of price volatility, trading continued uninterrupted in March 2020 across derivatives markets. Markets did not seize up despite some abnormal price moves, and market participants were able to take confidence that markets continued to operate as trading in derivatives remained open and liquidity was accessible.

2.21 Two respondents said that adding new classes of derivatives in scope of the DTO is likely to create additional compliance burden at a time when market participants are focusing their resources on preparing for LIBOR cessation. They noted that this could potentially result in disruption to the LIBOR transition process.

2.22 However, another respondent said that they did not believe that the proposed changes would slow, hinder or disrupt the LIBOR transition.

2.23 Another respondent suggested that, to reduce the risk of disrupting the LIBOR transition process, we could consider the impact of removing products from the DTO separately from the impact of adding new products. The respondent felt that the former is likely to involve much less implementation effort than the latter. This is because adding new products will require changes to systems and controls, staff training, coordination with and connectivity to trading venues, and communications with affected clients globally.

Our response

We note the additional benefits raised in terms of expected impact.

We note the concern over the additional compliance burden alongside the LIBOR transition. We focus on data-driven analysis to ensure appropriate calibration of the DTO. The analysis shows that, where relevant, market participants are already transitioning well. The changes also support a key outcome in the 2020/21 FCA Business Plan of an orderly transition from LIBOR to relevant RFRs.

We understand that we could consider the impact of removing products from the DTO separately from adding new products, and that the implementation effort can be expected to be lower for the former. However, we assessed each separately, including the compliance burden, as part of our CBA in CP21/22 and concluded that total estimated benefits are likely to outweigh the costs.

We also think our estimated costs are likely to be at the higher end of what the actual costs of our changes might be. Based on our available information, there is a very large overlap between the market participants that are currently subject to the DTO, and those that would be subject to it following implementation of the amendments. Since the DTO initially took effect in 2018, the impact will be much more limited than when it was introduced at that time. This is because the systems to deal with instruments subject to a trading mandate have now been in place for some time.

We also note relevant points under our response to question 5 below. We, therefore, maintain our position on expected impact of the DTO on the liquidity of derivatives and on the commercial activities of end-users which are not financial entities.

Liquidity analysis

2.24 We presented our liquidity analysis in Chapter 4 of CP21/22. We set out our analysis grouped by the currencies under consideration, and then assessed each currency by the criteria set out under UK RTS 4. No single liquidity measure was determinative on its own but was considered together with all of the other ones. We asked:

> **Q4:** ***Do you agree with the liquidity analysis set out above? If not, please provide explanations and data to support your response.***

2.25 We received 12 responses; they generally agreed with our liquidity analysis.

2.26 One respondent agreed that they do not currently see sufficient liquidity in €STR and SOFR products. They noted that various initiatives may help build liquidity but, given EURIBOR will continue, they believe further guidance will be needed to build liquidity in €STR.

2.27 One respondent noted that given the data provided below, the market would welcome a DTO (and DCO) for USD SOFR products. They also highlighted that JPY and CHF RFR adoption is increasing in pace, which shows how quickly markets can change and liquidity can develop; and that an efficient and quick review process will be necessary:

- The latest ISDA-Clarus data shows that overall adoption of RFRs is now moderately increasing. It reached 14.1% in July 2021 as measured by DV01 across all 6 currencies (AUD, CHF, EUR, GBP, JPY, and USD). This is the second consecutive all-time high, increasing from 11.7% in June 2021.
- The ISDA-Clarus RFR Adoption Indicator for USD shows that July 2021 saw 7.4% of all USD IRD risk transacted versus SOFR. This matched the previous 2 high readings and represents an increase from the 5.6% end of 2020 indicator mentioned in CP21/22. These readings only partly represent the significant change seen in the USD markets since we published CP21/22.
- Clarus data, which uses US post-trade transparency data, shows that approximately 20% of all USD risk is transacted versus SOFR for the first 3 weeks following SOFR First. This reached as high as 23.4% in the latest reading before the respondent submitted their response in mid-August 2021. This represents a significant increase.
- Using LCH SwapClear data to analyse what has happened in USD markets on a weekly basis for the first 3 weeks following SOFR First, they found that up to 28% of swaps risk has been transacted versus USD SOFR. Each week has seen over 24% of risk transacted versus SOFR, a new all-time high for SOFR adoption.
- Lastly, they highlighted that more than 67% of SOFR volumes reported to SDRs has been executed on-SEF in the first 3 weeks following the SOFR First initiative. This shows that the market is voluntarily choosing to execute their risk on-SEF. If, as mentioned under question 8, up to 75% of risk is already transacted on-venue

(in the 3 weeks following SOFR First) it argues strongly that a DTO would have no negative impact on the market.

2.28 The same respondent separately noted that GBP markets have traded over 50% of risk versus SONIA for the past 4 consecutive months up to the end of July 2021. Latest data strongly supports the conclusions regarding SONIA OIS and GBP LIBOR. They also noted that the use of EMIR data was particularly interesting to see, and that this public data needs to be made freely available for any intended use. According to the respondent, this would improve transparency and resiliency of markets, and would allow market participants to be more informed about RFR adoption.

Our response

We are grateful for this additional data. As part of our analysis presented in Chapter 3 we have been reviewing more recent public sources of data, including from IHS Markit and ISDA-Clarus.

On the comment that EMIR trade repository data should be made freely available for any intended use, we note that trade repositories do publish aggregated data, which is anonymised on their websites given the sensitive content of trade reports.

In conclusion, respondents generally agreed with the liquidity analysis in CP21/22. Chapter 3 also supports this analysis.

Proposals

2.29 We presented our proposals in Chapter 4 of CP21/22 as below.

Swaps based on GBP LIBOR and SONIA

2.30 Our liquidity analysis indicated that OIS referencing SONIA as a class of OTC derivatives is sufficiently liquid to impose a DTO. We proposed to remove derivatives referencing GBP LIBOR under the current DTO and replace them with OIS referencing SONIA.

2.31 We proposed to extend the DTO for SONIA OIS to trade start types spot-starting and IMM (next 2 IMM dates) with tenors of 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 12, 15, 20, 25 and 30 years. According to our analysis, these are sufficiently liquid. Of these tenors and trade start types, the 1, 8, 9, 12 and 25 year are new tenors and the IMM (next 2 IMM dates) are a new trade start type that we proposed to bring into scope of the DTO in addition to those currently covered by the DTO for GBP LIBOR IRS.

2.32 On timing, we proposed aligning the timelines for making changes with those of the broader RFR transition. Under this approach, implementation dates for changes to the DTO will align with changes to the DCO.

Swaps based on EURIBOR and €STR

2.33 Our analysis showed that OIS referencing €STR did not yet display the same level of liquidity of EURIBOR or other products currently subject to the DTO. We would consider including €STR products in the DTO once we are satisfied that the class of derivatives is sufficiently liquid. As relevant EURIBOR-based swaps continued to be sufficiently liquid at the time of the analysis conducted in CP21/22, we proposed to maintain them as part of the DTO.

Swaps based on USD LIBOR and SOFR

2.34 Liquidity in OIS referencing SOFR as a class of OTC derivatives is developing. It may well increase rapidly over coming months. But, at the time of our analysis in CP21/22 SOFR OIS did not yet meet relevant criteria to be sufficiently liquid for the purposes of the DTO. USD LIBOR derivatives did continue to be sufficiently liquid. The Bank had not proposed any changes to the DCO for USD products and contract types referencing USD LIBOR continue to be subject to the DCO. We did not propose any changes to the DTO with respect to USD products.

2.35 We asked:

> **Q5:** ***Do you agree that LIBOR transition plans have provided market participants with sufficient time to prepare within the proposed timelines for the changes described above? If not, please explain what transition period is needed and why?***

2.36 We received 12 responses to this question. Most respondents agreed that LIBOR transition plans have given market participants sufficient time to prepare for the changes proposed in our consultation.

2.37 Several respondents supported the alignment of our changes to the DTO with the CCP conversion date and the Bank's modification to the DCO. One respondent said that it was important to ensure that the relevant DTO is removed at the same time, or before, the DCO. Another noted that the removal of the DCO should automatically lead to the removal of the DTO.

2.38 One respondent, who also supported the proposed timelines for changes to the DTO, said that while LIBOR transition plans have provided clear timelines and have been supported by statements from the regulatory authorities, they are still challenging given the volume of affected instruments. They noted that there are wider outstanding issues, such as outstanding legacy contracts, requiring significant resources to make necessary changes.

2.39 One respondent agreed that LIBOR transition plans have given sufficient time for market participants to anticipate the transition from GBP LIBOR swaps to SONIA OIS. However, they were concerned that the addition of new products requires a range of technical changes which can only be planned in detail once the proposed changes are finalised. This leaves little time to prepare for implementation of the amended DTO. In addition, ESMA is consulting on changes to the EU DTO; and the CFTC have not yet indicated its approach for GBP LIBOR or SONIA OIS products. This means market participants operating in multiple jurisdictions will be required to ensure trading obligation implementation plans can differentiate between different territorial scopes, and likely under differing timelines. Therefore, the respondent encouraged us to consider splitting the (i) removal of GBP LIBOR products from the DTO (aligning with the related DCO on 20 December 2021) and (ii) the addition of new SONIA OIS products (no sooner than the end of Q1 2022). The respondent felt this would give market participants time to implement the new DTO product changes without affecting transition plans and would allow time for additional clarity to emerge about US and EU plans.

2.40 Another respondent agreed with the timelines we proposed, however they also raised concerns about the removal of GBP LIBOR products and the introduction of SONIA OIS products to the DTO on the same date. They noted that this could place additional regulatory burden on market participants at a time when there is already potential for market disruption from LIBOR cessation. The respondent asked us to consider an additional phase-in period of 6 months, so that market participants would only be required to comply with any new DTO for transactions concluded from the end of the phase-in period.

2.41 Another respondent highlighted the significant resources involved in preparing for LIBOR cessation at the end of 2021. They were concerned that the focus on LIBOR transition plans could be diluted by the need to prepare new systems and procedures needed for any new obligations. They urged us to postpone the implementation of any new DTOs, including SONIA, until at least 2023. The respondent believes this would cause little risk to regulatory objectives, as evidence suggests that market participants will continue to trade on-venue in absence of an obligation, where appropriate.

Our response

Firstly, on the comment that there are wider issues, such as outstanding legacy contracts, we are aiming to confirm our decisions on which legacy contracts will be permitted to use synthetic GBP and JPY LIBOR rates as soon as practicable in Q4 2021, following consultation. Any synthetic LIBOR will be time limited, so market participants should continue active transition away from LIBOR wherever possible.

We note that a few respondents are concerned about the potential challenges market participants may face if a new DTO is introduced at the same time as removal of GBP LIBOR swaps, and would prefer a delay to the implementation date of a DTO for new products. As noted in our response to question 3 above, we assessed each separately, including the compliance burden, as part of our CBA in CP21/22 and concluded that total estimated benefits are likely to outweigh the costs. We have not seen any evidence from the feedback that would challenge this analysis and expect the actual net benefit of such changes to be greater than the CBA anticipates.

We consider that the timetable we set out have provided market participants with sufficient time to prepare for the amendments put forward. It is also comparable to the timelines that applied when the DTO was first introduced, which covered a much broader set of changes.

We have found that most SONIA products are already voluntarily traded on-venue. We also consider it logical to align with the Bank, so that the DCO and the DTO come into force on the same date.

We recognise the issue raised by firms regarding the implementation date for changes to the DTO alongside the LIBOR transition programme. But we have decided, on balance, not to amend the date proposed in our consultation paper as a delay would potentially result in reduced transparency on the more liquid contract. Therefore, the amendments to the RTS will come into force on 20 December 2021.

Q6: ***Do you agree with our proposal with respect to €STR products? If not, please explain why and please provide supporting data where possible.***

2.42 We received 12 responses generally agreeing with our proposal for €STR products.

2.43 All respondents agreed that there is not currently sufficient liquidity in €STR OIS products to include them in scope of the DTO. As such, respondents welcomed our proposal to monitor market developments and liquidity in €STR OIS products and consider including these in the DTO only when we are satisfied that these classes of derivatives are sufficiently liquid. One respondent asked us to consider the length of time required to consult and enact changes appropriately.

2.44 Several respondents noted that trading activity in €STR products is likely to increase as relevant transition deadlines and milestones draw closer (ie the CCP transition from EONIA to €STR; the €STR First Initiative; and the Cross-Currency Swaps Initiative). One respondent asked us to review the €STR market before the end of 2021, once these changes have come into effect.

2.45 One respondent said that further guidance will be needed to build €STR liquidity and with this, working closely with other jurisdictions to align dates of change will be important.

2.46 Another respondent suggested that we monitor €STR products for all tenors, including maturities beyond 3 years as per the scope of the DCO. As well as the emerging liquidity in the longer-term products, we should also consider alignment in tenors across the currencies in scope of the DTO.

Our response

We agree that these transition plans will help build liquidity in €STR swaps and we will continue to monitor liquidity and relevant market developments in €STR-based products, including in longer-termed tenors.

The feedback received and the updated analysis presented in Chapter 3 support our proposals on €STR products. We therefore maintain our approach.

Q7: ***When might be the right time to remove USD LIBOR products from the scope of the DTO? Please provide supporting data where possible.***

2.47 We received 10 responses to this question, with respondents expressing a diverse range of views.

2.48 Three respondents said that the right time to remove USD LIBOR products from the DTO would be in tandem with the decommissioning of USD LIBOR in June 2023.

2.49 Two respondents said it is likely that sufficient progress will have been made on the USD LIBOR transition to justify removing USD LIBOR products from the DTO this year. One respondent added that the risks to regulatory objectives of removing the DTO are limited compared to those of maintaining it inappropriately. Another stated that if it is not possible to remove USD LIBOR products from the DTO on short notice, then it may be necessary for us to provide for regulatory relief if market participants become unable to clear in-scope USD LIBOR products (as CCPs announce their LIBOR transition plans to cease clearing certain products) or trade them on-venue.

2.50 Another respondent said that while they expect liquidity in USD LIBOR products to significantly decrease at the beginning of 2022, they did not see this as a reason to remove these products from the DTO as trading venues will be able to continue to process orders. The respondent said it would be preferable to maintain the DTO for USD LIBOR products for as long as practicable, so that market participants have continued transparency. They also noted that SOFR products should be introduced before removing USD LIBOR products from the DTO to prevent the USD swaps market potentially going dark. This would risk the USD swaps market losing the benefits of resiliency, stability and transparency.

2.51 Three respondents added that the removal of USD LIBOR products from the scope of the DTO would need to be aligned with their removal from the DCO and similar CCP plans to convert existing USD LIBOR-based swaps to RFR-based equivalents.

2.52 One respondent said that it was challenging to estimate the right time to remove USD LIBOR products from the DTO. However, they emphasised the importance of coordination and alignment with relevant authorities globally to avoid challenges in implementation by market participants. Two of the 3 respondents who suggested the right time to remove USD LIBOR products from the DTO would be June 2023 also supported global coordination.

Our response

We note the diverse range of responses received, including the concerns raised about the risks of maintaining USD LIBOR products as part of the DTO inappropriately.

We will continue to monitor liquidity and market developments in USD products and be mindful of these concerns, in particular any announcements that relevant CCPs or trading venues may make. However, we have not yet received any feedback that would suggest that maintaining the DTO would make market participants unable to manage their risks in USD LIBOR swaps.

We will continue to engage with relevant market participants and authorities, including in the US, to understand when the right time might be to remove USD LIBOR from the scope of the DTO.

We also note that the Bank has confirmed in its publication on 29 September that it expects to consult on changes to the DCO relating to the contract types referencing USD LIBOR in 2022. We will continue to coordinate our approach with the Bank to ensure that timely changes can be made to the DTO, when appropriate.

Q8: ***Do you agree with our proposal with respect to SOFR products? If not, please explain why and please provide supporting data where possible.***

2.53 We received 11 responses to this question. Most respondents agreed with our proposal for SOFR products. One respondent disagreed and asked that we review our conclusion for USD markets and impose the DTO on OIS referencing SOFR.

2.54 Most respondents agreed that there is not yet sufficient liquidity to introduce a DTO in SOFR OIS products. However, several respondents noted that they expect liquidity in these products to develop in the coming months as relevant transition deadlines and milestones draw closer. As such, respondents agreed that we should continue monitoring market developments and liquidity over the coming months.

2.55 One respondent said that a potential date to consider inclusion of SOFR in the DTO is January 2022, and no later than June 2022.

2.56 One respondent disagreed with our conclusion not to include SOFR OIS products within the scope of the DTO. They highlighted that over 90% of USD SOFR volumes are already cleared on a voluntary basis, as reported to SDRs. They also noted that between 67-75% of USD SOFR risk has traded on-SEF in the first 3 weeks since the SOFR First initiative was introduced on 26 July 2021. In turn, the respondent argued that SOFR markets would benefit from the imposition of the DTO (and DCO).

2.57 One respondent said that subject to changes in liquidity over the coming months, any addition of SOFR products to the scope of the DTO should be aligned with their addition to the DCO, and coordinated with other regulators that have similar mandates.

2.58 One respondent said that as the centre of liquidity is likely to remain in the US for these products, we should allow US authorities to take the lead on any requirements.

2.59 Some respondents, as mentioned under question 7, asked that we coordinate our approach with relevant authorities globally.

Our response

We note the response disagreeing with our proposal not to include SOFR products in the DTO at this time. However, we are required to consider the specific criteria referred to in Article 32 of UK MiFIR and UK RTS 4. The updated analysis presented in Chapter 3 continues to support our proposals for USD products as the criteria do not yet appear to be met.

In the absence of a clearing mandate, given recent levels of liquidity and in line with most of the feedback received, we are not amending our approach.

We do, however, agree that relevant deadlines and milestones are likely to impact liquidity. We will, therefore, continue to coordinate our approach with the Bank and monitor market developments and liquidity in USD LIBOR and SOFR OIS products.

3 Liquidity analysis

3.1 Since publishing CP21/22, we have continued to monitor the relevant derivatives markets to understand whether there have been any developments in the use of relevant RFR OIS products which may justify amending the scope of the DTO from that originally proposed. In this Chapter we present our updated liquidity analysis.

3.2 As in CP21/22, we use the ISDA-Clarus RFR Adoption Indicator to summarise the state of adoption of RFRs in all major jurisdictions and currencies. An ISDA-Clarus whitepaper details the scope of data used and how the indicators are constructed.

3.3 We present our time series findings on a granular weekly frequency, where appropriate, rather than monthly as in our analysis in CP21/22. This is so we can focus on developments in relevant derivative products since CP21/22 was published, for which the data period covered was January to April 2021. In this PS we assess the products up to the end of July 2021.

3.4 We have used data sources that were accessible to us within the time available, including both quantitative and qualitative data from EMIR trade repositories and public data sources. We have considered all of the relevant criteria set out in Article 32 of UK MiFIR and UK RTS 4. However, our key findings below focus on the ISDA-Clarus RFR Adoption Indicator, and only certain criteria.

3.5 As with CP21/22, for those types of contracts currently subject to the DTO, we performed our updated analysis on the IRS that reference LIBOR benchmarks which are spot starting and IMM (next 2 IMM dates) as set out in the FCA's register. For those OIS contracts referencing relevant RFRs, our analysis uses the same standardised contract specifications included in CP21/22.

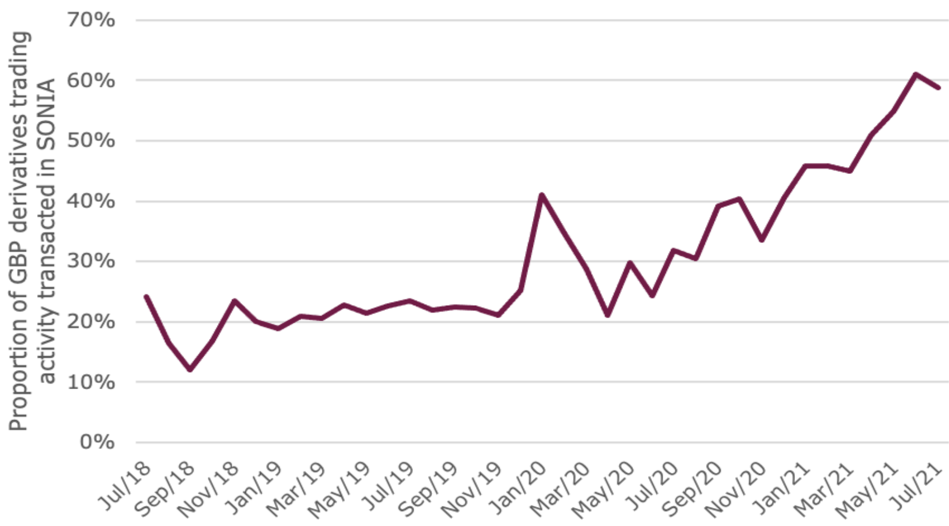
3.6 Lastly, the criteria on the average frequency of trades must be assessed over a sufficient period to determine whether the liquidity of each class of derivatives, or a relevant subset thereof, is subject to seasonal or structural factors. With additional data between the end of April and the end of July 2012 we were able to cover a longer period of time. However, it was, as before, challenging to account for seasonal and structural factors as the market is still adapting following the UK's withdrawal from the EU and the LIBOR transition is not yet complete.

3.7 We set out our liquidity, grouped by relevant currencies.

Analysis on GBP LIBOR and SONIA swaps

3.8 The ISDA-Clarus RFR Adoption Indicator confirms the increasing trend in the use of SONIA products. It has remained the dominant IRD sterling product, since it overtook GBP LIBOR in usage in March 2021. SONIA now accounts for 61% of all GBP derivatives trading activity and has traded over 50% of risk for the past 4 months up to the end of July 2021, as shown in Figure 1 below.

Figure 1: Proportion of GBP derivatives trading activity transacted in SONIA

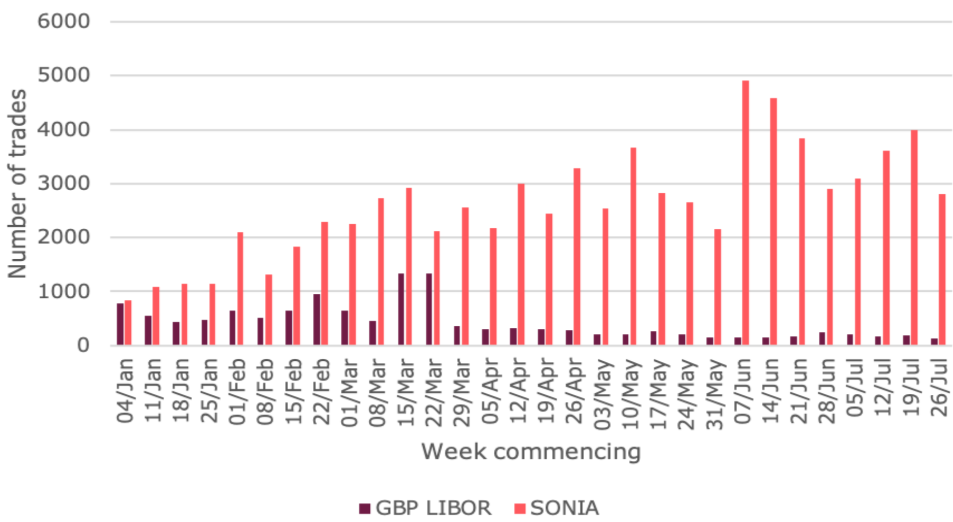


Source: Clarus Financial Technology

3.9 We noted in CP21/22 that at the turn of the year GBP LIBOR and SONIA trading activity were roughly similar and that since then SONIA has strongly increased in activity over GBP LIBOR.

3.10 This trend has continued. SONIA has continued its increasing trade count, whereas GBP LIBOR now registers fewer than 500 trades per week and has done so since end-March. SONIA trades now significantly outnumber GBP LIBOR trades.

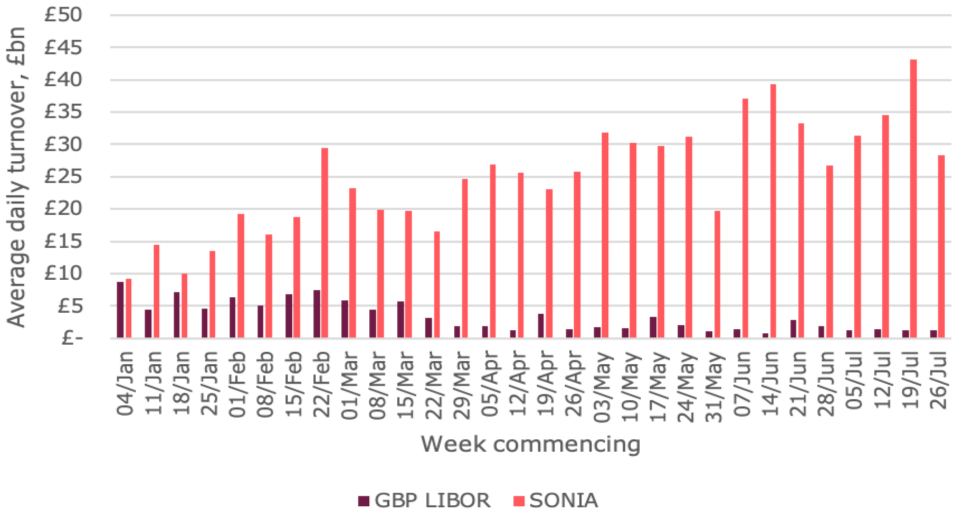
Figure 2: Number of GBP derivatives trades, over time



Source: FCA on EMIR data, January – July 2021

3.11 Trading activity measured by the average daily turnover shows a quite similar picture as that for the number of trades.

Figure 3: GBP derivatives turnover, over time

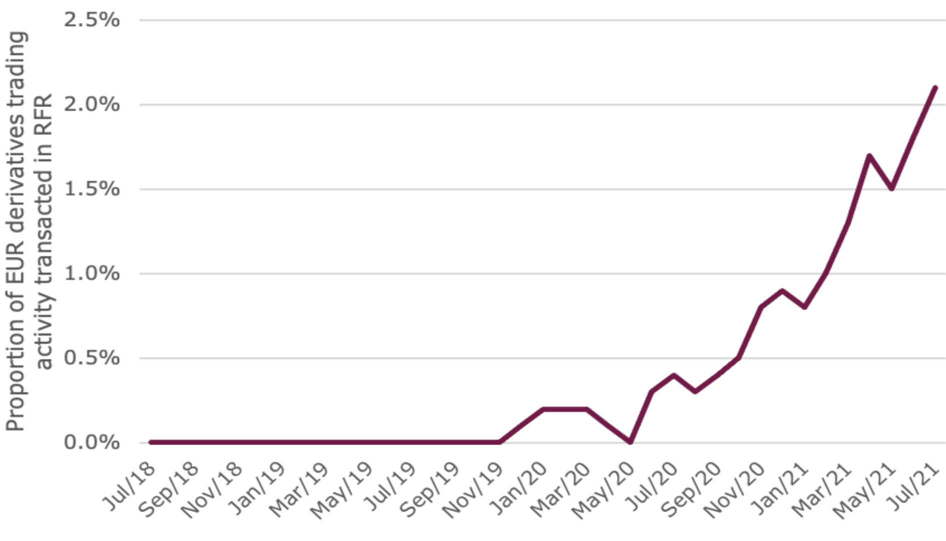


Source: FCA on EMIR data, January – July 2021

Analysis on EURIBOR, EONIA and €STR swaps

3.12 The ISDA-Clarus RFR Adoption Indicator for €STR has increased in the previous months but remains low on an absolute basis. €STR usage is now at 2.1%. This represents an increase, albeit not at significant levels, since the time of our analysis for CP21/22, from 1.3% of DV01 at end-March 2021.

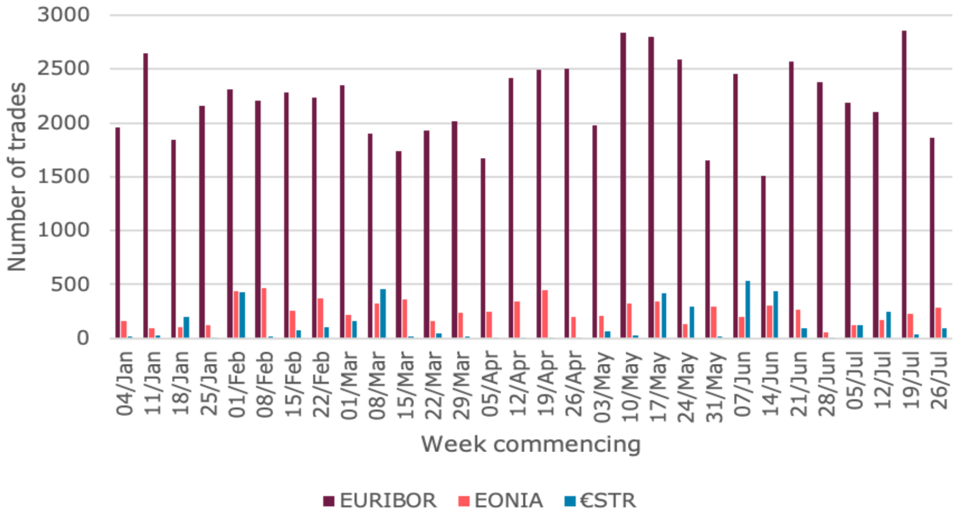
Figure 4: Proportion of EUR derivatives trading activity transacted in RFR



Source: Clarus Financial Technology

3.13 EURIBOR activity, represented by number of derivatives trades, remains high throughout the observation period. Both EONIA and €STR products register a fraction of that for EURIBOR. €STR products have not had a sustained period of activity, with some weeks of activity followed by some with almost no activity.

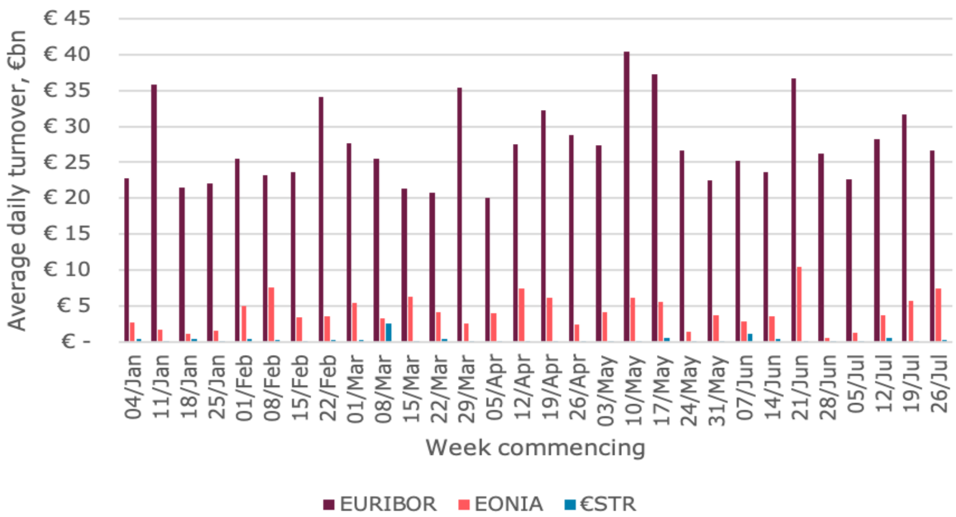
Figure 5: Number of EUR derivatives trades, over time



Source: FCA on EMIR data, January – July 2021

3.14 Trading activity measured by the average daily turnover shows a quite similar picture as that for the number of trades. Compared to number of trades, €STR products show lower activity under the turnover metric.

Figure 6: EUR derivatives turnover, over time

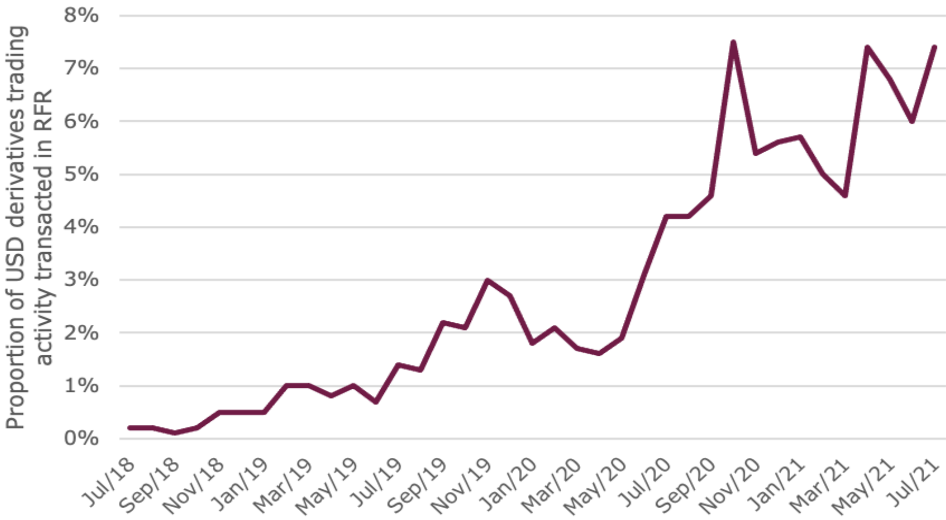


Source: FCA on EMIR data, January – July 2021

Analysis on USD LIBOR and SOFR swaps

3.15 The ISDA-Clarus RFR Adoption Indicator for USD derivative products has shown an increasing trend. SOFR usage has ranged between 4 to 8% since mid-2020, with peak usages observed of 7.5% in October 2020 and 7.4% in April and July 2021.

Figure 7: Proportion of USD derivatives trading activity transacted in RFR

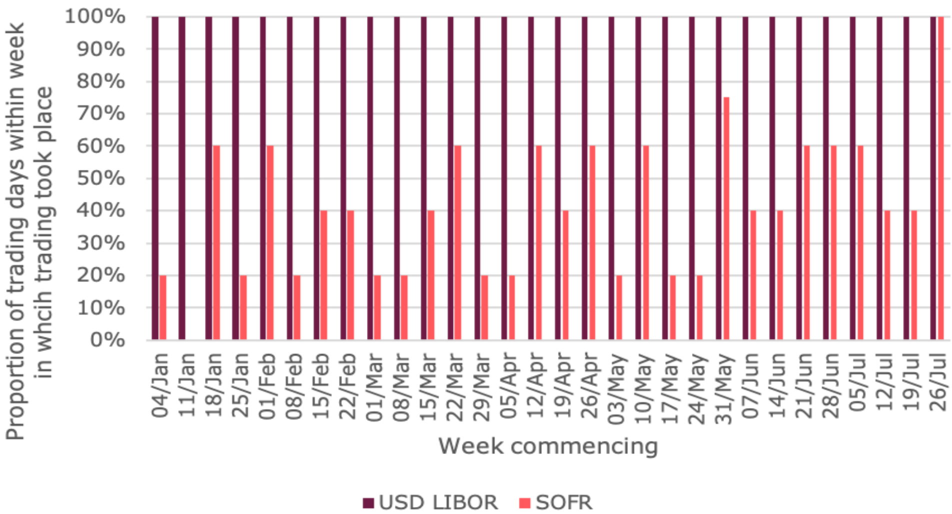


Source: Clarus Financial Technology

3.16 USD LIBOR has continued to remain active during the observation period. SOFR activity appears to be slowly increasing, from single days of activity around the beginning of 2021 to 3 days of the week as the year has progressed.

3.17 The week of 26 July 2021 saw SOFR being active on every trading day, for the first time. The impact of the SOFR First initiative, which recommends that on 26 July 2021 and thereafter interdealer brokers replace trading of LIBOR linear swaps with trading of SOFR linear swaps, as described in Table 1, can be seen from this.

Figure 8: Proportion of days in which USD derivatives trading took place, over time

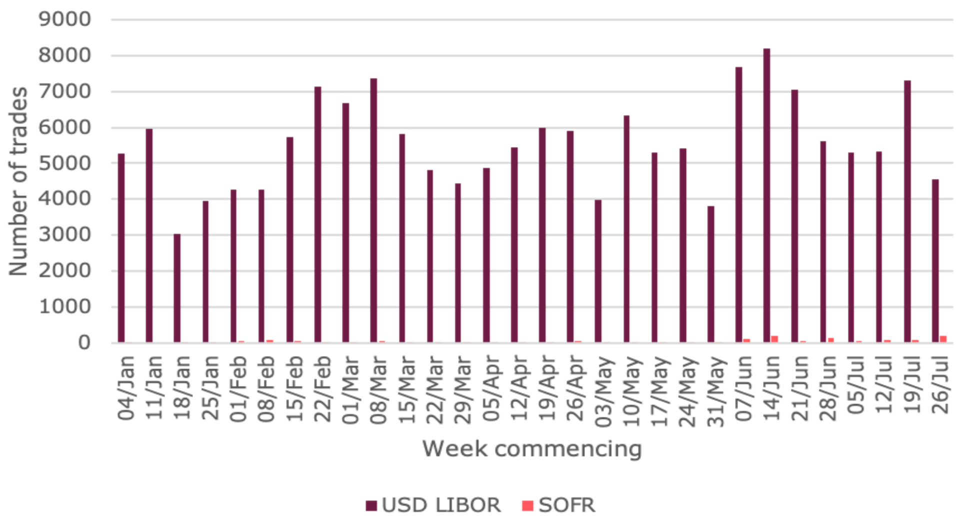


Source: FCA on EMIR data, January – July 2021

3.18 While increasing activity can be seen for SOFR products through frequency of trades, this is less apparent through the number of trades. Here, USD LIBOR remains dominant. At this time, USD LIBOR does not show any discernible trend of winding down, but this may change following the SOFR First initiative.

3.19 SOFR activity is increasing over time. However, this cannot be seen due to the sheer relative scale of USD LIBOR activity. In the period between the start of the year and May 2021 we observe a weekly trade count of on average 25, while in June and July 2021 we see that increase to 100, ie a four-fold increase.

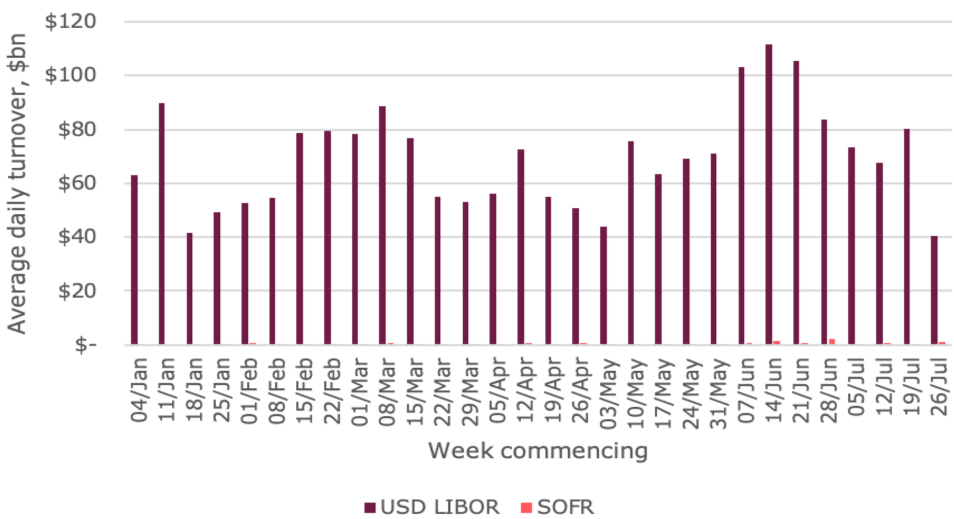
Figure 9: Number of USD derivatives trades, over time



Source: FCA on EMIR data, January – July 2021

3.20 The evidence is similar for turnover. For SOFR product activity, in the period between the start of the year and May 2021 we observe a weekly average turnover of approximately $1.1bn. In the period since, this has increased to approximately $4.2bn, a similar near four-fold increase.

Figure 10: USD derivatives turnover, over time



Source: FCA on EMIR data, January – July 2021

3.21 Active market participants for USD LIBOR products is high. This is the case for all tenors. In the most active products, upwards of 70 active market participants have been observed.

3.22 We are also starting to see market participation increase for SOFR products. From a base of below 10, active market participation has approximately doubled in the period up to July 2020, culminating in the participation in the SOFR First initiative.

3.23 In conclusion, the trends we saw in CP21/22 are supported by our updated liquidity analysis and, overall, we do not see any reason to amend the proposals in CP21/22.

4 Our changes to the list of derivatives subject to the DTO

4.1 Below we confirm the changes to be made to the list of derivatives subject to the DTO. We have implemented the proposals we consulted on in CP21/22 in line with our liquidity analysis covering the period between January and July 2021, and the responses we received to the consultation paper.

Swaps based on GBP LIBOR and SONIA

4.2 Our liquidity analysis shows that OIS referencing SONIA as a class of OTC derivatives is sufficiently liquid to impose a DTO. We are removing derivatives referencing GBP LIBOR under the current DTO and replacing them with OIS referencing SONIA.

4.3 The DTO for SONIA OIS will apply to trade start types spot-starting and IMM (next 2 IMM dates) in the following tenors of 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 12, 15, 20, 25 and 30 years for which there is sufficient liquidity.

4.4 These changes will come into force on 20 December 2021. Our implementation date for changes to the DTO is aligned with the date on which the Bank's modifications to the DCO will come into force.

Swaps based on EURIBOR and €STR

4.5 Our analysis showed that OIS referencing €STR did not yet display the same level of liquidity of EURIBOR or other products currently subject to the DTO. We would consider including €STR OIS in the DTO once we are satisfied that the class of derivatives is sufficiently liquid. We will continue to monitor liquidity and market developments in €STR OIS markets.

4.6 As relevant EURIBOR-based swaps continue to be sufficiently liquid, we maintain them as part of the DTO.

Swaps based on USD LIBOR and SOFR

4.7 Liquidity in OIS referencing SOFR as a class of OTC derivatives is developing. It may well increase rapidly over coming months. But, at the time of the analysis SOFR OIS did not yet meet relevant criteria to be sufficiently liquid for the purposes of the DTO while USD LIBOR derivatives continue to be sufficiently liquid, for now.

4.8 The Bank has not made any changes to the DCO for USD products and contract types referencing USD LIBOR continue to be subject to the DCO. We take the same position for the DTO.

4.9 The position in the market is still evolving and, as a result, we are likely to propose further amendments to the DTO in due course. We will continue to monitor market developments and liquidity in USD LIBOR and SOFR products.

Annex 1
List of non-confidential respondents

Alternative Investment Management Association

Citadel LLC

Clarus Financial Technology

IHS Markit

International Swaps and Derivatives Association, Inc

Investment Association

Annex 2
Abbreviations used in this paper

Abbreviation	Description
ARRC	Alternative Reference Rates Committee
Bank	the Bank of England
CBA	cost benefit analysis
CCP	central counterparty
CFTC	Commodity Futures Trading Commission
CP	consultation paper
DCO	derivatives clearing obligation
DTO	derivatives trading obligation
EMMI	European Money Markets Institute
EONIA	Euro Overnight Index Average
ESMA	European Securities & Markets Authority
€STR	Euro Short-Term Rate
EU	European Union
EURIBOR	Euro Interbank Offered Rate
FCA	the Financial Conduct Authority
FICC	Fixed Income Clearing Corporation
FMSB	FICC Markets Standards Board
FRA	forward rate agreement
FSMA	Financial Services and Markets Act 2000
G20	Group of Twenty
IMM	international monetary market
IRD	interest rate derivative
IRS	interest rate swap
ISDA	International Swaps and Derivatives Association
MTF	multilateral trading facility
OIS	overnight indexed swap
OTC	over-the-counter
OTF	organised trading facility
PS	policy statement

Abbreviation	Description
RFR	risk-free rate
RM	regulated market
RTS	regulatory technical standards
SDR	swap data repository
SEF	swap execution facility
SOFR	Secured Overnight Financing Rate
SONIA	Sterling Overnight Index Average
TONA	Tokyo Overnight Average
UK BMR	onshored Benchmark Regulation (EU) 2016/1011
UK EMIR	onshored Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories
UK MiFIR	onshored Regulation (EU) No 600/2014 on Markets in Financial Instruments
UK RTS 2	onshored Commission Delegated Regulation (EU) 2017/583
UK RTS 4	onshored Commission Delegated Regulation (EU) 2016/2020
UK RTS on the trading obligation for certain derivatives	onshored Commission Delegated Regulation (EU) 2017/2417

All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 7066 7948 or email: publications_graphics@fca.org.uk or write to: Editorial and Digital team, Financial Conduct Authority, 12 Endeavour Square, London, E20 1JN

Annex 3
The regulatory framework

1. Article 32 of UK MiFIR sets out the procedure for determining the application of the DTO. Article 32(1) and (5) of UK MiFIR empower the FCA to make technical standards to specify which class of derivatives or subset thereof that is subject to the DCO is subject also to the DTO.

2. Article 32(2) of UK MiFIR specifies that in order for the DTO to take effect the class of derivatives must meet both of the following criteria:

- the venue test: it must be admitted to trading or traded on at least one relevant trading venue; and
- the liquidity test: there must be sufficient third-party buying and selling interest in the class of derivatives so that it is considered sufficiently liquid to trade only on the relevant trading venues. Article 32(3) and (6) of UK MiFIR and UK RTS 4 list a set of criteria and provide further detail respectively for determining whether a class of derivatives or a relevant subset thereof is sufficiently liquid as below:

a. the average frequency and size of trades over a range of market conditions, having regard to the nature and lifecycle of products within the class of derivatives.

3. The average frequency of trades: the number of days on which trading took place and the number of trades.

4. The average size of trades:

i. the average daily turnover whereby the notional size of all trades combined shall be divided by the number of trading days;
ii. the average value of trades whereby the notional size of all trades combined shall be divided by the number of trades.

5. The analysis of the average frequency of trades should take account of the distribution of trading executed on trading venues and OTC. Criteria should be assessed over a period of time of sufficient length to determine whether the liquidity of each class of derivatives or a relevant subset thereof is subject to seasonal or structural factors. Consideration should be given to whether trades are concentrated at certain points in time and over certain sizes over the period assessed and determined to what extent such concentration constitutes predictable patterns.

b. the number and type of active market participants including the ratio of market participants to products/contracts traded in a given product market:

i. the total number of market participants trading in that class of derivatives or relevant subset thereof is not lower than two;
ii. the number of trading venues that have admitted to trading or are trading the class of derivatives or a relevant subset thereof;
iii. the number of market makers and other market participants under a binding written agreement or an obligation to provide liquidity.

6. The analysis should compare the ratio of market participants to the findings in the data obtained for the analyses of average size of trades and the average frequency of trades.

c. The average size of the spreads:

i. the size of weighted spreads, including volume weighted spreads, over different periods of time;
ii. spreads at different points in time of trading sessions.

7. Where information on spreads is not available a proxy should be used for the assessment of this criterion.

8. Article 32(5) of UK MiFIR requires the FCA to amend, suspend or revoke existing UK RTS on the DTO for certain derivatives if there is a material change in the criteria.

Appendix 1
Made rules (legal instrument)

TECHNICAL STANDARDS (MARKETS IN FINANCIAL INSTRUMENTS REGULATION) (DERIVATIVES TRADING OBLIGATION) INSTRUMENT 2021

Powers exercised

A. The Financial Conduct Authority ("the FCA") makes this instrument in the exercise of the powers and related provisions in or under:

(1) article 32(1) of Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012; and

(2) the following sections of the Financial Services and Markets Act 2000 ("the Act") as amended by the Financial Regulators' Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018:

(a) section 137T (General supplementary powers);
(b) section 138P (Technical standards);
(c) section 138Q (Standards instruments); and
(d) section 138S (Application of Chapters 1 and 2).

B. The rule-making powers listed above are specified for the purposes of section 138Q(2) (Standards instruments) of the Act.

Pre-conditions to making

C. The FCA has consulted the Prudential Regulation Authority and the Bank of England as appropriate in accordance with section 138P of the Act.

D. A draft of this instrument has been approved by the Treasury in accordance with section 138R of the Act.

Modification

E. Commission Delegated Regulation (EU) 2017/2417 of 17 November 2017 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on the trading obligation for certain derivatives, which is part of UK law by virtue of the European Union (Withdrawal) Act 2018, is amended in accordance with the Annex to this instrument.

Commencement

F. This instrument comes into force on 20 December 2021.

Citation

G. This instrument may be cited as the Technical Standards (Markets in Financial Instruments Regulation) (Derivatives Trading Obligation) Instrument 2021.

By order of the Board
30 September 2021

In this Annex, underlining indicates new text and striking through indicates deleted text.

Annex

Commission Delegated Regulation (EU) 2017/2417 of 17 November 2017 supplementing Regulation (EU) 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on the trading obligation for certain derivatives

…

ANNEX

Derivatives subject to the trading obligation

…

Table 3 ~~**Fixed-to-float interest rate swaps denominated in GBP**~~

~~**Fixed-to-Float single currency interest rate swaps – GBP LIBOR 3 and 6M**~~		
~~**Fixed leg**~~		
~~**Floating leg**~~		
~~Settlement currency~~	~~**GBP**~~	~~**GBP**~~
~~Trade start type~~	~~Spot (T+0)~~	~~Spot (T+0)~~
~~Optionality~~	~~No~~	~~No~~
~~Tenor~~	~~2,3,4,5,6,7,10,15,20,30Y~~	~~2,3,4,5,6,7,10,15,20,30Y~~
~~Notional type~~	~~Constant Notional~~	~~Constant Notional~~
~~Payment frequency~~	~~Quarterly or semi-annual~~	~~Quarterly or semi-annual~~
~~Day count convention~~	~~Actual/365F~~	~~Actual/365F~~

~~Reference index~~	~~GBP LIBOR 6M~~	~~GBP LIBOR 3M~~
~~Reset frequency~~	~~Semi-annual or quarterly~~	~~Quarterly~~
~~Day count convention~~	~~Actual/365F~~	~~Actual/365F~~

[deleted]

…

***Table 5* Overnight indexed swaps denominated in GBP**

Overnight indexed swaps – GBP SONIA		
Floating leg		
Settlement currency	**GBP**	**GBP**
Trade start type	Spot (T+0)	IMM (next 2 IMM dates)
Optionality	No	No
Tenor	1,2,3,4,5,6,7,8,9, 10,12,15,20,25,30Y	1,2,3,4,5,6,7,8,9,10,12,15,20,25,30Y
Notional type	Constant Notional	Constant Notional
Fixed leg		
Payment frequency	Annual or semi-annual	Annual or semi-annual
Day count convention	Actual/365F	Actual/365F
Floating leg		
Reset frequency	Annual, semi-annual or quarterly	Annual, semi-annual or quarterly

Day count convention	Actual/365F	Actual/365F

Pub ref: 007736

FINANCIAL
CONDUCT
AUTHORITY

12 Endeavour Square London E20 1JN
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk