Perspectives
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JASON GRANET & EDWIN SCHOOLING LATTER: Keep Calm & Carry On in the LIBOR Transition

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Featuring:

Jason Granet, Chief Investment Officer, BNY Mellon and BNY Mellon's Executive Sponsor of the LIBOR Transition program

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Moderated by Garrett Marquis, Global Head of External Communications, BNY Mellon

GARRETT MARQUIS: Hi everyone, this is Garrett Marquis, Global Head of External Communications here at BNY Mellon. Welcome back for another episode of our BNY Mellon Perspectives podcast.

Today, we have a discussion centered on a watershed moment in recent financial history: the transition away from The London Interbank Offered Rate, or LIBOR. To put this in context, the benchmark rate affects around $300 trillion of trades globally.

Following several years of global regulators and central banks driving international efforts to phase out the use of LIBOR in favor of robust alternatives known as Risk Free Rates, the end of the publication of LIBOR is imminent.

To mark this significant milestone, BNY Mellon's Jason Granet met with Edwin Schooling Latter, Director of Markets and Wholesale Policy for the United Kingdom's Financial Conduct Authority. Some of you may remember Jason from other Perspectives podcasts. He wears a few hats here, including as Chief Investment Officer, but he is also Executive Sponsor for BNY Mellon's LIBOR Transition program, and he's worked closely with global stakeholders on the transition for years. Edwin is one of the most consequential voices and leaders guiding the transition.

Jason and Edwin sit down to reflect on lessons learned from the U.K.'s move away from LIBOR, implications for the U.S. dollar transition, and the next big shift in markets once the LIBOR transition is complete. They make this hugely important but somewhat difficult topic accessible to anyone interested in financial markets, and they have fun doing it.

Please enjoy, and as always, please listen, rate, review and subscribe wherever you get your podcasts. See you at the next episode.

JASON GRANET: All right, here we go. What a wonderful opportunity we have today. Thank you very much, Mr. Edwin Schooling Latter, for joining us here on BNY Mellon Perspectives. It's obviously a very appropriate time to have you join us. As folks may or may not know, Edwin is with the [United Kingdom's Financial Conduct Authority (FCA)]. He's one of the key participants in what has been a massive undertaking here in the LIBOR transition. Just let us get us going.

Edwin, why don't you kind of introduce yourself, talk about your role and, most importantly, just to educate folks broadly, how has the FCA come to be in the world of LIBOR? That's something that is a little bit of a mystery. You have all these global interest rates, yet everything seems to fall in the U.K.

EDWIN SCHOOLING LATTER: Yeah. Thank you, Jason, pleasure to be with you today. As you said, I'm Edwin Schooling Latter. I'm the Director of Markets and Wholesale Policy and Wholesale Supervision at the U.K.'s FCA, or Financial Conduct Authority. The FCA regulates securities and derivatives markets. It supervises banks as well as almost all other U.K. financial-sector firms.

For those more familiar with U.S. agency structure, for example, the FCA is a sort of combination of the [Securities and Exchange Commission], the [Commodity Futures Trading Commission] and parts of the Federal Reserve.

And the reason that we have a particular role to play in the LIBOR transition is because the FCA is actually the supervisory regulator of the LIBOR interest rate benchmarks. And that means, in particular, we supervise the benchmarks administrator – a company called ICE Benchmark Administration, or IBA.

We supervise the submission of data to LIBOR. We have to judge whether the rate remains representative of the market it's supposed to measure. We have powers to intervene – to mitigate risks associated with production of the benchmark – and all those powers apply to U.S. dollar LIBOR just as much as they did or do to sterling LIBOR.

JASON GRANET: Thanks Edwin, I think you gave us good perspective on why we're chatting. And so, when I think back to the last watershed date, it was July 27, 2017 when our good friend Mr. Andrew Bailey gave a speech that set off this chain of events leading to the end of 2021. And I remember hearing countless times, "Oh, that's crazy"; There's no way this is going to happen"; "LIBOR is ubiquitous, there's no way."

And, sure enough, here we are in the beginning of 2022, that [cessation] date has come and gone, and that monumental moment in financial history has kind of happened. And so can you talk about the buildup to that? Going back to July of 2017, when you were staring at some "financial [Mount] Everest" to climb and thinking about how to do this. Talk about some of the key benchmarks and items we tackled to get from there to here at the end of the year.

EDWIN SCHOOLING LATTER: OK, that's a great perspective to take Jason. As you said, it was back in July 2017 when the FCA announced that it would not be keeping LIBOR going beyond the end of

2021. Of course, I had the advantage of knowing that announcement was about to be made. In fact, I was in Washington D.C. when the speech was published. I can remember exactly where I was, a nice hotel in Alexandria, [VA] actually, having my morning coffee and looking at the coverage in the Washington Post. As you said, the reaction from contacts in financial markets was one of incredulity, and that's because LIBOR was referenced in contracts with a notional value of something like $265 trillion across derivative, bonds, loans, mortgages and other consumer products. That looked a pretty daunting task, and there were a lot of really key decision points along that journey.

In fact, the date itself in 2021 was one that we discussed very carefully with other stakeholder authorities in the United States, in Japan, in Switzerland in particular. There was some really key work by [International Swaps & Derivatives Association] to tease out a global consensus on the right fallback for LIBOR in derivative contracts. That consensus was subsequently adopted across many other products as well. It's really great that some have commented since the switch off of the sterling, yen, Swiss franc, Euro, LIBOR panels. But in practice, that's been something of a Y2K moment, so almost unnoticeable in the world at large. If it stays that way, that's a really great outcome and indeed beyond what I would've dared to hope for back in July 2017.

JASON GRANET: And so, thinking about that, you mentioned a couple things there that I'll get into, but just on this idea of reflecting: obviously when we were looking at that long road, that clearly could have been bumpy. What were some of the big lessons that were learned through that period that might be applicable beyond just – we'll get into some things happening here in the U.S. with LIBOR – but beyond this, that market participants can take away more broadly?

EDWIN SCHOOLING LATTER: Yeah, I think there are quite a number of those. One I'd particularly like to highlight is how much the industry and regulators can achieve when they work together. There have been lots of big regulatory reforms over the years. Sometimes those go relatively smoothly, sometimes not so smoothly. But in my experience, what really made this one standout was the fact it was a team effort, it was cooperative right from the beginning. And I think we certainly look to draw from that, replicate that in the future. Of course, there were lots of other elements that helped: I would pull out, for example, the fact that we set clear dates to work to some years in advance, and we stuck to them. I think that matters.

I think in terms of that authorities' industry coordination, the [Sterling Overnight Index Average] SONIA-first initiatives – where we got participants in relevant markets to come together and decide today was the day to put the new risk-free rate benchmark first and LIBOR rate second – I think those were very important. They didn't mean absolute change in one day, but they were really important inflection points in building the new markets. And of course, U.S. authorities and industry have subsequently done the same for [Secured Overnight Financing Rate (SOFR)] with their various SOFR-first initiatives.

JASON GRANET: Look, you talked about teamwork there, I couldn't agree more, definitely in the industry working groups I've been involved in – U.S., global and otherwise – the coordination and the communication, especially. You and I have had that, we've had it with some of our other colleagues – always transparent, both sides always willing to listen. I think that I agree with you and I think the industry can take that away, that if you have constructive conversations at the table, then we can think about the best way to get from point A to point B in the financial landscape.

And what was really interesting to me about this [LIBOR transition] was how global it was. You had mentioned earlier you had coordinated with the U.S., Switzerland, Japan, all these others. Talk about the international collaboration, because one of the things that I think goes kind of unappreciated in global finance is how intertwined the markets are. LIBOR is a poster child for how intertwined global markets are. But talk about the international coordination here, I think, that was critical to some of the achievement.

EDWIN SCHOOLING LATTER: It's a great question, and one that came up a lot during the process; that, candidly, I think market participants were always worried about whether international authorities were talking to each other enough. But when you were in one of those authorities, liaising with our counterparts in the Fed or Bank of Japan or with [Japanese Financial Services Agency] was a weekly, sometimes even a daily reality, and indeed partly, perhaps, due to the pandemic to a degree. There were periods where I felt I'd spent more time in David Bowman's living room in a virtual way than in my own office.

Some of that discussion, of course, took place bilaterally or in group calls between the authorities. Some of it took place in the formal structures that helped bring international authorities together in what, after all, are international financial markets. Things like the Financial Stability Board set up back in the day as part of learning the lessons from previous financial stresses and the importance of coordination, I think, really proved their worth as a vehicle to coordinate and get together and have a single common voice on the need to do things, the reason for doing things, the timetables by which they needed to be done.

JASON GRANET: Obviously, no one has been closer to the core of the apple on this than you in so many different ways. Let's talk about where we are right now. We're recording this here in January of 2022. The end of 2021 has come and gone, just as Mr. Bailey predicted back in July of 2017. The lion's share of the LIBOR rates have come and gone, we'll get into some nuances. What exactly went into making this all so smooth at the end of the year? And how can we think about applying that as we look at the summer of '23 for the U.S.? You were right there, front row seats, et cetera. What happened to make it so, knock on wood, easy here at the end of last year?

EDWIN SCHOOLING LATTER: We've touched on some of what I think are the key factors there already, but not all of them. When I say what have we touched on already? Well, it was having clear dates and sticking to them. It was having consensus on what successor arrangements looked like. It was that team effort across the industry and authorities and across jurisdictions. I think the other bit, frankly, was preparation and communication. Preparation in terms of the enormous amounts of work done across a very large number of firms, banks or asset management companies, or in some cases, non-financial corporations as well, to be ready for those deadlines. And a massive effort to keep communicating. One of my colleagues used to say, "Repetition is the mother of all understanding." And I'm sure I will have bored some people with constant speeches on LIBOR, but I think that last year, for example…

JASON GRANET: Do you know how many speeches you did give? Do you know how many?

EDWIN SCHOOLING LATTER: I do know that my team pointed out to me that in 2021, we did 77 pieces of communication, public communication, on LIBOR. So enough for anyone. I hope. Perhaps one other thing, in terms of comparing the U.K. experience now done, as it were, and the U.S. experience to come, I should say, firstly, that many parts of that journey are the same. And that should give everyone involved in the journey confidence that it can be successful, and it can be smooth. Even more so as firms – the big firms are obviously present both in the U.K. and in the U.S. – they can learn from the small glitches that did occur on the sterling side.

One advantage that we did have in the U.K., and indeed in Switzerland, was that there was never any serious suggestion from market participants that we needed credit-sensitive rates anymore. It was unambiguous from the beginning that SONIA would be the future center of gravity of interest rate markets. SONIA, like SOFR in the U.S., is easy for users to understand. It's got a strong central bank backing and it's the most robust interest rate benchmark available, and I'm aware that that bit of the journey in U.S. dollar interest rate markets has been a little bit more complicated.

And what do I mean by glitches, you might reasonably ask? These are small things. The end of the sterling, yen, Swiss franc weekend, which was over the New Year holiday – it's just taken place – I'd say we saw 98 percent success in terms of the successful operational application of fallbacks. But yeah, there were a few examples of systems being unable to apply those fallbacks to more exotic trades without manual intervention, or unexpected and seemingly incorrect impact on trade value or risk metrics in the systems for non-standard trades. But no really major problems that we know about at the moment, at least. And the big international firms, as I said earlier, will be able to learn from that sterling experience when it comes to the end of U.S. dollar LIBOR.

JASON GRANET: Definitely in the U.S., the ball is rolling downhill and gathering a good amount of steam. Look, one tool that we talked about very early, it took a little bit of a rollercoaster [ride] – and evolved into having a piece of the puzzle here –was using synthetic rates to bridge gaps in different parts of the market for different types of rates. In the U.K., there was some introduction of synthetic for some use to manage some of this transition. Can you first define synthetic, because I think it gets used, but make sure that people fully understand that. Then secondly, talk about exactly how it's used in the context of managing this here in the short term in the U.K., and then potentially what that could mean here in the U.S.

EDWIN SCHOOLING LATTER: Yes. Synthetic LIBOR is something that becomes possible because of one of those powers that we have as the regulator and supervisor of LIBOR.

JASON GRANET: Maybe they'll make a Marvel superhero movie about you guys soon if you have superpowers, maybe they will.

EDWIN SCHOOLING LATTER: Well, I am a fan, but I'm not sure I have delusions of that kind. But synthetic LIBOR comes from this power we have to be able to require the administrator of LIBOR to publish the rate using a different methodology in certain circumstances. And one of those circumstances is where the rate is no longer representative, because those are panels from which it used to be compiled and no longer meet, therefore it's no longer representative. And we have used that power in respect of sterling and yen LIBOR, and respect of some of the settings, not all of them; we didn't use it for Swiss or for euro LIBOR. And we've used the power to require publication of a LIBOR number on the familiar LIBOR screens.

But that number is actually composed of the relevant risk-free rate term version of the relevant risk-free rate, so SONIA for sterling, TONA for yen, plus a fixed and never-changing spread. The combination of those two things is a fair and reasonable approximation of what LIBOR might have been into the future. And the way we've chosen that methodology and that fixed spread means that the expected value of that aligns completely with the cross-jurisdictional global consensus on fair fallbacks for LIBOR. There's no advantage in waiting for synthetic LIBOR rather than putting in place transition agreement with your customer, or you signing the ISDA protocol.

JASON GRANET: Edwin, just to clarify, that means the math links to what the [Alternative Reference Rates Committee] has come up with U.S. dollar fallbacks, the math links to what ISDA's come up with derivative fallbacks across currency? Under every rock, the math is kind of the same. That was the thinking there?

EDWIN SCHOOLING LATTER: Exactly, it takes you to the same place. I think there's no doubt that having that there for anyone who hadn't managed to reach agreement with their counterparty who is still this month looking at IBAs or Reuters or Bloomberg's screen for the LIBOR number, they will see that synthetic number composed from risk-free rates, they'll be able to use it for this year. And I think that helped achieve a sort of smooth landing for the transition. Really important thing to say though, Jason, is that no one should assume that will also happen for U.S. dollar LIBOR. On the U.S. dollar side, we and the U.S. authorities and the panel banks agreed to a different way of buying a bit more time to deal with the legacy transactions. And that, of course, is the extension of 18 months until June 2023 of the U.S. dollar LIBOR panel. That's what's designed to address the legacy problem in the U.S. dollar.

JASON GRANET: Got it. So slightly different tack there, taking the 18- month production in the U.S., the synthetic for – I believe it's one year period in sterling and some of the other items. Should the market think about anything in the context of these different paths that were taken between the U.S. and U.K., or is really the end game the same and market participants should approach it similarly?

EDWIN SCHOOLING LATTER: I think, being especially back in spring of last year when we announced the different arrangements for sterling, yen and dollar, there was a lot of focus on the headline difference in terms of longevity of the panel. And I've always tried to highlight to people that , underneath that headline difference, there's actually enormous similarity in that both synthetic LIBOR for yen and sterling and the panel for U.S. dollars are only for use in legacy contracts. None of those are for use in new contracts. And obviously all of those, whether it's the panel or the synthetic rates, they will come to an end after a reasonable period to complete the transition. Really, it's the similarities, not the differences, that are most striking.

JASON GRANET: Obviously, we had this run up in December for the other currencies, and now to kind of bring it in real time, now the spotlight on the movie has shifted over to the U.S. markets and the run up to next summer now that we're in ’22, the summer of ’23 and July 1 or June 30, depending on how you keep track at home. No better way to celebrate America's birthday weekend, I guess next year, than waving goodbye to LIBOR. What's one message that you can send to U.S. markets, or maybe two messages, that you learned over the run up in the last few weeks of last year that we can think about applying as we think about the next 17, 18 months?

EDWIN SCHOOLING LATTER: I think that's an easy one, actually, because the real lesson from the sterling transition, and indeed the yen and the Swiss franc ones, based on the things we've learnt from firms there and from our counterpart authorities in those countries, is that it is generally possible to reach agreement with counterparties to change contracts within the time that is now available to do so. Massive success from banks here, in Japan, in Switzerland, in terms of getting those agreements to switch to the new risk-free rates, and both sides, or all sides, of those transactions agreeing that was the sensible thing to do.

If you want to avoid that unsettling risk of contract frustration at the end of June 2023, then you can do so. That route is open. And I would say, don't wait. There's no time like the present. Expertise and awareness, they're probably at their highest. There's lots of LIBOR transitioning experts out there now, and you also have the really encouraging precedent of success that this does work in other currencies and other jurisdictions.

JASON GRANET: Again, going back to 2017 and the incredulity that you referenced, I don't think people would've claimed that it would've happened, and people would be focused on a lot of other things. I think about this and I think about taking a peek inside. You joke about your conversations with David in your living rooms and such – obviously COVID has taken this in an interesting direction – and if you were to layer a pandemic on top of that when Mr. Bailey spoke, none of us would've predicted the success here. What are some pieces of advice or lessons that you were given along the way, or maybe even prior in your career, that you used as you climbed this mountain here and took this on, against obviously the face of a lot of people questioning its possibility at the beginning?

EDWIN SCHOOLING LATTER: That's quite a tough one, that one. And I think that my answer is never assume that you've got nothing more to learn about a subject and always encourage others to criticize your ideas. But here is the bit that one of my previous bosses advised me and I've been grateful for, is that if the evidence in front of you does point in one direction rather than another, then keep making the case. Because either you will learn something really important from what others say back to you or, if you are right, then others will be persuaded in the end. And I think there were a few bits of this journey, and going to specifics, where it looked like quite hard to win people around to what we thought the right path was. But in the end, consensus around those things formed, and that was hugely important.

JASON GRANET: Yeah, consensus is powerful, especially across the globe. We talked about the smoothness that happened in the other currencies. We’re focused on it in the U.S. You’ve spent such a disproportionate amount of your time and energy on this over the last three, four years. What are the things that you're thinking about and focused on? Obviously markets are evolving every day. Quite frankly, the markets are very different than they were three, four years ago when we started this conversation. There are so many different things in the ether that are causing things in the market. What are some of your shifts, or what would you say are some of the things that the FCA is thinking about now that this monumental item is somewhat either past or deeply in train?

EDWIN SCHOOLING LATTER: Yeah, another great question. And yeah, I am very pleased at the prospect of being able to spend a little bit more time on things other than LIBOR transition, notwithstanding my pleasure at the successes that have been achieved on the LIBOR front. There are lots of things happening in financial markets that all of the listeners to this will be very aware of and I think are going to have some pretty fundamental impacts. And the one that comes to mind is obviously the impact of ESG considerations on investment and other operational decisions.

But for me, personally, I think one thing I'm particularly looking forward to –and using the benefit of that experience on the LIBOR side of industry and authorities working together – is working on the U.K.'s post-Brexit financial market landscape. We obviously have a wonderful opportunity to shape the rules here and to coordinate with participants here, and we have the great benefit – to many international participants in U.K. financial markets – to make that regulatory framework the best possible one for firms looking to conduct financial business. And as we come out of this pandemic and it becomes more possible to meet people face-to-face again in the room, I sense tremendous enthusiasm for quite a lot of ways to do that, and quite a lot of consensus on the things we can do together to make financial markets work even better.

JASON GRANET: Brexit, pandemic, so many things layered on top of this change. And we still collectively, as you indicate, in a globally coordinated way, were able to pull off one of the biggest foundational changes in financial markets. It's pretty remarkable, I'm glad I was able to watch it happen in real time. Before we close, any other final thoughts here, Edwin, on last takeaways that people should think about? Obviously, the big change, I think you gave some good nuggets before, around "no time like the present." But any last parting thoughts before we let you go?

EDWIN SCHOOLING LATTER: Well, I'll come to that in just a moment, though I did want to say, Jason, that I think you and many others, possibly many others listening to this, will have done more than just watch. That you, and team members back in New York, were really important players in helping to land this successfully. And that then goes to reiterating a key message, which is that this has, it seems in very large part, worked smoothly. It can clearly do so for the U.S. dollar, as well. That does require team effort. It does require preparation for the key dates, which will come. But be encouraged that it will work.

I think last of all, be encouraged not only by the success in avoiding disruption from transition, but by the fact that actually the end of LIBOR and the move to risk-free rates takes us to a stronger financial system. Because those rates are not only more robust and more transparent, but also they're probably better for almost all the purposes for which interest rate benchmarks are used.

Most of those derivatives are about hedging the general level of interest rates, not bank credit risk. It never made any sense for companies to issue bonds referencing benchmarks that could go up in times of economic stress, as credit concerns around financial institutions change. It never really made any sense for consumers to be hitched to a benchmark that they had virtually no hope of understanding, and which did expose them to that risk that interest payments would go up just at the time when the economy was heading south instead. It's been a long journey, it's been quite a lot of work, but it's been a worthwhile one.

JASON GRANET: Well, thank you for that. One thing's for sure – you and I have an opportunity in front of us for many years to get invited to business school classrooms and explain what that LIBOR thing was once upon a time and how it changed.

Edwin Schooling Latter, the U.K.'s Financial Conduct Authority's Director of Markets and Wholesale Policy, one of the key people in driving forward one of the most foundational changes here in financial markets. We can't thank you enough for your time. I thank you for all of your collaboration personally, and thank you for joining us here on this episode of BNY Mellon Perspectives. Look forward to chatting with you again soon. Thanks so much.

EDWIN SCHOOLING LATTER: Thank you very much.

GARRETT MARQUIS: Hey everyone, Garrett here again. Thanks again for joining. I hope you enjoyed that conversation. As I said at the top, keep listening on Apple Podcasts, on Spotify or wherever you consume your podcasts. Most importantly, if you're willing, leave a review or a rating and tell us your feedback. You can find us on social media – LinkedIn, Twitter, Facebook, Instagram – and BNYMellon.com. Thanks for listening. We'll see you at the next episode.

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