HM Treasury

Supporting the wind-down of critical benchmarks

Consultation

February 2021

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Contents

Chapter 1
Introduction

1.1 On 21 October 2020, the government introduced the Financial Services Bill to Parliament. This Bill includes amendments to the Benchmarks Regulation (BMR), which provide the Financial Conduct Authority (FCA) with new and enhanced powers to oversee the orderly wind-down of critical benchmarks, such as LIBOR.

1.2 Firms should continue to prioritise active transition away from LIBOR to alternative benchmarks. It is in the interests of financial markets and their customers that the pool of contracts referencing LIBOR is shrunk to an irreducible core ahead of LIBOR's expected cessation after the end of 2021.[1]

1.3 It is HM Treasury's intention to support a smooth transition away from LIBOR, given the financial instability and market disruption risks that could be caused by a disorderly transition or end to LIBOR. Therefore, the Financial Services Bill legislation aims to ensure that the FCA has the appropriate regulatory powers to manage and direct any wind-down period prior to eventual LIBOR cessation in a way that protects consumers and preserves market integrity.

1.4 Specifically, the Financial Services Bill amends the BMR to enable the FCA to manage a situation in which a critical benchmark has become or is at risk of becoming unrepresentative and it may be impractical or undesirable to restore its representativeness.[2] In particular, the FCA may designate a benchmark that is unrepresentative or is at risk of becoming unrepresentative under Article 23A, with the result that its use (as defined in the BMR) is prohibited by virtue of Article 23B, except where legacy use is permitted by the FCA under Article 23C. The Article 23A benchmark may be published under a changed methodology, which may no longer be representative of the underlying market or economic reality that the benchmark sought to measure, using powers under Article 23D, in order to facilitate an orderly cessation. The FCA will exercise these powers where it considers it necessary to further its objectives of consumer protection and preserving market integrity.

1.5 There is clear recognition from the financial services industry in the UK, and internationally, that the government's legislation is a crucial step in

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[1] FCA consults on new benchmark powers, November 2020 (https://www.fca.org.uk/news/statements/fca-consults-on-new-benchmark-powers), FCA response to IBA's proposed consultation on intention to cease US$ LIBOR (https://www.fca.org.uk/news/statements/fca-response-iba-proposed-consultation-intention-cease-us-dollar-libor)

[2] Financial Services Bill, Part 2: Benchmarks, Clauses 8-21 (as introduced to the House of Lords) (https://publications.parliament.uk/pa/bills/lbill/58-01/162/5801162en.pdf)

mitigating the risks that may otherwise crystallise upon LIBOR's expected cessation, given the number of legacy contracts that face significant or insurmountable barriers to transition away from LIBOR to an alternative appropriate benchmark. A number of other jurisdictions are also bringing forward legislation to support an orderly cessation of the LIBOR benchmark.

1.6 It is therefore HM Treasury's intention to minimise, as far as is reasonably possible, any disruption arising from LIBOR transition. HM Treasury would be concerned if the exercise of these powers resulted in significant litigation and/or market disruption.

1.7 Since the introduction of the Financial Services Bill to Parliament, a number of stakeholders have approached HM Treasury to suggest incorporating a supplementary legal 'safe harbour' for relevant legacy contracts. Specifically, these stakeholders envisage that a legal safe harbour would act as a helpful contingency in reducing the potential risk of contractual uncertainty and disputes in respect of certain legacy contracts referencing or relying upon a benchmark that has been designated as an Article 23A benchmark, and that may be subject to a change in methodology under Article 23D.

1.8 Stakeholders have suggested that a legal safe harbour would apply to legacy contracts (i.e. contracts written before an Article 23A designation is announced), and would have one or both of the following features:

1 It would provide for legal certainty that references to a critical benchmark in certain legacy contracts should continue to be read as such following its designation as an Article 23A benchmark and any changes made to its methodology under Article 23D.

2 It would provide that neither the designation of a critical benchmark as an Article 23A benchmark nor any change to the methodology under Article 23D would in itself be a basis for either a cause of action, liability or grounds for litigation between parties to contracts.

1.9 In particular, stakeholders have suggested that neither the designation nor methodology change should have the effect of:

- Discharging or excusing performance under any contract (including, but not limited to force majeure or other provision that alters the parties' obligations and/or liabilities)
- Giving any party the right unilaterally to terminate or suspend performance under any contract
- Giving rise to liability for a facility agent / calculation agent (or any person in a similar role or role ancillary to the main contract) where they use the rate after designation under Article 23A in performance of their obligations under the contract
- Constituting a breach of contract
- Voiding any contract
- Amending, modifying or novating a contract.

1.10 Given this feedback, and HM Treasury's intention to allow for a smooth transition, we are therefore seeking views on whether a legal safe harbour could be a helpful supplement to the provisions inserted into the BMR by the Financial Services Bill. Therefore, this consultation looks to gain views on whether there is a case for introducing legislation and, if it is warranted, the design and scope of any such legislation.

1.11 As LIBOR contracts are varied in terms of drafting and structure across different business sectors, we would encourage responses to this consultation from a wide range of sectors and firms who hold contracts referencing LIBOR.

Chapter 2

Rationale for any legal safe harbour provisions

2.1 HM Treasury is interested to understand the likely causes of action, potential liabilities or grounds for litigation that would support the case for a legal safe harbour. Importantly, HM Treasury welcomes views on how these could inform the operative elements of a legal safe harbour.

2.2 Specifically, HM Treasury is interested in whether, and if so how, it could provide greater legal certainty for contracts that reference or rely on a benchmark that has been designated as an Article 23A benchmark that may be subject to a change in methodology under Article 23D.

2.3 While it is HM Treasury's intention to minimise, as far as is reasonably possible, any disruption arising from LIBOR transition, any legislation would need to be supported by strong evidence of an actual detriment that needed to be addressed, and would need to pursue a legitimate aim and do so in a proportionate manner. It is unlikely that the government would be able to legislate for every specific eventuality and, as such, any legal safe harbour provisions would be aimed at minimising, as far as is reasonably possible, significant risk and uncertainty in the interpretation and operation of contracts referencing or relying on a benchmark following its designation as an Article 23A benchmark and any changes made to its methodology under Article 23D.

Box 2.A: Questions

1 If a critical benchmark is designated as an Article 23A benchmark, and subject to a possible change in methodology under Article 23D, how might this create contractual uncertainty?

2 Subject to responses to the previous question, would this contractual uncertainty lead to causes of action, potential liabilities or grounds for litigation, between parties to contracts, or between other parties? If yes, please specify:

- the nature of the causes of action, liabilities or grounds for litigation that could arise
- how likely they would be, the circumstances and the likely timing in which these could arise
- possible impacts (quantitative and qualitive) on contractual parties and the wider market

3 Do you consider that a legal safe harbour is necessary in order to mitigate the impacts you have identified in response to the questions above?

If you consider that there is a material need for a legal safe harbour to be introduced:

4 Should any legal safe harbour contain the features highlighted by HM Treasury's stakeholder feedback (as set out in Chapter 1)? Please set out your reasoning, with reference to the Financial Services Bill provisions.

5 Are there any circumstances in which we should explicitly exclude the application of a legal safe harbour and, if so, why?

6 Should a legal safe harbour only be required for contracts entered into before a benchmark is designated under Article 23A , and therefore any contracts entered in to after an Article 23A designation should not be in scope of safe harbour?

7 Should any legal safe harbour apply to third parties such as facility agents, trustees or parties to contracts ancillary/collateral to the main contract that reference or rely upon an Article 23A benchmark? If so, how?

Chapter 3
Scope of any legal safe harbour

3.1 Subject to the government's decision on introducing a legal safe harbour, there are several scope-related issues to consider in its possible application.

3.2 Firstly, the UK can only provide a possible legal safe harbour for contracts governed by UK law. HM Treasury understands that financial contracts often use the law of England and Wales as their governing law and expects that any legal safe harbour would cover contracts where the law of England and Wales is the choice of law, regardless of the jurisdiction of the parties to the contracts. This consultation seeks views on this approach.

3.3 Secondly, the BMR-related provisions on the 'use' of a critical benchmark in the Financial Services Bill apply to 'supervised entities' and specified 'financial instruments', 'financial contracts' or 'investment funds'. However, contracts referencing critical benchmarks are widespread, across varying sectors, industries and product types. For example, LIBOR is used by a wide range of contractual parties, not all of whom are 'supervised entities', and it is used in a wide variety of contracts, not all of which are 'financial instruments', 'financial contracts' or 'investment funds' covered by the BMR. The application of the benchmark goes beyond 'use' as defined within the scope of the BMR.

3.4 In line with the government's objective to minimise, as far as is reasonably possible, any disruption arising from LIBOR transition, it may be that any legal safe harbour should extend to those contracts that sit outside of the definitions of 'use' and 'supervised entity' within the BMR, applying to all legacy contracts.

3.5 Thirdly, HM Treasury will need to consider whether and how any legal safe harbour should apply to a legacy contract that makes express reference not only to the critical benchmark in question but also, or instead, describes the benchmark or the underlying market it intends to measure. For example, in relation to LIBOR there are contracts that do not refer to 'LIBOR' specifically, rather they reference the 'screen rate' or the underlying market that is intended to be measured by LIBOR.

3.6 The Financial Services Bill makes clear that, where contracts are entered into or operating in breach of either a prohibition applied by the FCA to the new use of a benchmark that is ceasing, or the general prohibition on the use of a critical benchmark following its designation as an Article 23A benchmark, such a breach would not affect the validity or enforceability of the contract (1B of Article 29 of the BMR as amended by the Financial Services Bill). Any legal safe harbour should follow this same approach, applying to legacy

contracts even where they may be entered into or operating in breach of a prohibition on use provided for under the Financial Services Bill.

3.7 Furthermore, it is also HM Treasury's view that any legal safe harbour provisions would not seek to override suitable contractual fallbacks that allow for contracts to move away from referencing or relying upon a critical benchmark following its designation as an Article 23A benchmark, and its possible change in methodology under Article 23D.

3.8 The government's position remains that contracts should transition away from LIBOR voluntarily, wherever possible. Safe harbour legislation should not prevent contracts from moving away from referencing or relying on a benchmark that has been designated as an Article 23A benchmark.

Box 3.A: Questions

If you consider that a legal safe harbour is needed in order to mitigate risks identified in response to the questions in chapter 2:

8 Do you have any comments on the jurisdictional issues set out above, or the proposed approach? In particular, can respondents provide any evidence of the volumes of LIBOR referencing contracts where the law of Scotland or Northern Ireland is the choice of law, that may benefit from safe harbour provisions?

9 Should the scope of any legal safe harbour go beyond supervised entities making 'use' of an Article 23A benchmark in specified 'financial contracts', 'financial instruments', and 'investment funds' as defined in the BMR?

10 Should a legal safe harbour provide for situations where a contract describes the benchmark alongside, or instead of, the express name of the benchmark in question? If so, how? Please provide examples of contract wording to illustrate your response.

11 How would we best ensure, within any legal safe harbour provisions, that parties to contracts falling in scope of the safe harbour retain the freedom to move away from referencing or relying upon a benchmark that has been designated as an Article 23A benchmark to alternative appropriate arrangements, or to terminate the contract, provided they reach consensual agreement?

In particular, how should safe harbour provisions interact with contractual fallbacks? Please provide examples of contractual wording where relevant.

In your response please provide any further views on how safe harbour provisions should be designed or scoped in order to address the risks identified in responses to the questions in Chapter 2.

Chapter 4

legal immunity for the administrator of a critical benchmark

4.1 In addition to the possibility of providing users of a critical benchmark with a legal safe harbour, HM Treasury is also considering whether there is a case for providing legal protections for the administrator of a critical benchmark, in particular when it publishes a critical benchmark that has been designated as an Article 23A benchmark and may be subject to a change in methodology under Article 23D.

4.2 In particular it would seem inappropriate to HM Treasury that an administrator, where they were acting under the direction of the FCA in the circumstances described above, and had no discretion, be subject to time consuming or expensive litigation over their actions.

Box 4.A: Questions

12 To what extent would a 'safe harbour', as described in previous chapters, mitigate the risk of litigation against the administrator? Are there still claims that could arise against the administrator of an Article 23A benchmark, and if so, how would they arise and what would they include?

13 Subject to the possibility of claims arising (as above), would it be appropriate to provide for legal protection for the administrator against specific legal claims or causes of action or liabilities? If so, how should these inform the design of any legal protections for the administrator?

In your answer, please consider HM Treasury's position (as stated above) that any legal protections from litigation would apply when an administrator is acting under the direction of the FCA following the exercise of their powers in the BMR as amended by the Financial Services Bill and would not apply otherwise.

14 Are there specific legal claims or causes of action or liabilities that should be expressly carved out of any legal protections afforded to the administrator?

Chapter 5

Responding to this consultation

This consultation will close on **15 March 2021**. We are inviting stakeholders to provide responses to the questions set out above, and to share views on the issues and proposed approach set out in this consultation.

Please submit your responses to **marketconduct@hmtreasury.gov.uk**, or post to:

Market Conduct Unit

Securities and Markets

HM Treasury

1 Horse Guards Road

SW1A 2HQ

More information on how HM Treasury will use your personal data for the purposes of this consultation is available on the webpage.

HM Treasury contacts

This document can be downloaded from www.gov.uk

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