

Financial Conduct Authority

12 Endeavour Square
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By email: benchmark-article23D@fca.org.uk

18 January 2021

Dear FCA team

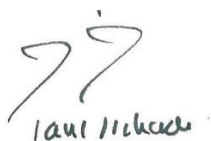
Consultation on proposed policy with respect to the exercise of the FCA's powers under new Article 23D

The International Capital Market Association (ICMA) is responding to the FCA's [Consultation on proposed policy with respect to the exercise of the FCA's powers under new Article 23D](#).

As you know, ICMA is the trade association for the international capital market with around 600 member firms from more than 60 countries, including issuers, banks, asset managers, central banks, infrastructure providers and law firms. See: www.icmagroup.org.

We would be happy to discuss any aspect of our response in due course.

Yours faithfully

A handwritten signature in black ink, appearing to read "Paul Richards", with a stylized flourish above the name.

Paul Richards
Head of Market Practice and Regulatory Policy
ICMA

ICMA RESPONSE TO FCA CONSULTATION ON ARTICLE 23D

General remarks

1. The issues surrounding LIBOR cessation in the context of legacy bonds that reference LIBOR are well known and recognised by various official sector working groups, including the Working Group on Sterling Risk-Free Reference Rates (the **RFRWG**).¹ The provisions set out in the Financial Services Bill relating to an orderly wind-down of LIBOR are therefore welcome. ICMA has been engaging with the development of these provisions, and monitoring related developments in the US and EU. This response is based on public sources of information.
2. Much of the FCA's proposed approach in relation to the exercise of its powers under the new Article 23D as set out in the consultation paper sounds sensible. In particular, the FCA's approach of focusing on LIBOR and then re-visiting policy statements for other benchmarks (per paragraph 1.8 of the consultation paper) is welcome given the importance of LIBOR.
3. It is also welcome that the FCA confirms, in paragraph 1.12 of the consultation paper, that it will consult the market on its proposed use of a forward-looking term RFR plus credit adjustment spread as the basis for any modified version of LIBOR ("synthetic LIBOR"). While we understand why this approach is being considered, it will be important to establish:
 - (i) whether the market accepts that there will be continuity of contracts that reference LIBOR when LIBOR's methodology is modified, and in particular that the risk of legal challenge is being minimised; and
 - (ii) whether the market accepts that the FCA's approach for sterling² LIBOR should differ in two potential ways from the proposed approach for US dollar LIBOR:
 - a. during the period between the end of 2021 and the end of June 2023, when it is proposed that sterling LIBOR would be based on a modified methodology on the grounds that the existing panel bank-based methodology will no longer result in a rate that is representative of its underlying market, while it is proposed that US dollar LIBOR will continue to be based on the existing panel-bank methodology on the grounds that it can continue to result in a representative US dollar rate, though use of US dollar LIBOR for new transactions would cease; and
 - b. at the end of June 2023, when sterling legacy transactions are expected to continue to use synthetic LIBOR introduced pursuant to UK legislation, while legislation has been proposed in the US and EU involving contract override. It will be important to establish whether the market accepts that there is international alignment between the different approaches and that the risk of confusion about which legislative solution applies in which circumstance is minimised.
4. It is important to note that contract continuity questions, and an associated risk of litigation, could potentially arise upon the introduction of synthetic LIBOR pursuant to provisions of the

¹ See [Paper on the Identification of Tough Legacy Issues](#), May 2020.

² We note that the FCA has [stated](#) that it appears unlikely that the conditions and inputs for use of its powers to require continued publication of euro and Swiss franc LIBOR will exist at the time these panels are proposed to cease, and the FCA will continue to assess whether it might be necessary and feasible to use the proposed powers in the case of more heavily used yen settings as transition progresses.

Financial Services Bill. The risk would be reduced, though cannot be eliminated, through the inclusion of deeming and safe harbour provisions in the Financial Services Bill or other relevant UK legislation. Paul Richards, Head of Market Practice and Regulatory Policy, ICMA, discussed this in his oral evidence to the [Public Bill Committee on the Financial Services Bill](#) on 17 November 2020. For ease of reference, Paul Richards' opening statement published in Hansard is set out in the Annex hereto. In addition, it will be important from a contract continuity perspective that the modifications that are made to LIBOR are as limited as possible in order to result in a benchmark that is as similar as possible to the previous benchmark (and at least ensure that the way in which the rate is presented on the relevant screen page and how relevant market participants can reference it remains the same).

5. We also note that certain debt instruments reference LIBOR-based benchmarks (such as the ICE Swap Rate), rather than LIBOR itself. It will be important for issuers and investors in these legacy instruments for clarity to emerge on how the introduction of synthetic LIBOR interacts with such LIBOR-based benchmarks, noting the work that is already being done in this area by the RFRWG (including the RFRWG's [letter](#) to ICE Benchmark Administrator of September 2020).

Q1: Do you have any view on how best to consult in respect of our prospective decisions to exercise our Article 23D(2) power in respect of LIBOR?

6. As envisaged in paragraphs 2.16 – 2.17 of the consultation paper, the FCA's overall aim should be to gather feedback from the market experts on the RFRWG and Sub-Groups and equivalent groups in other jurisdictions, as well as a wide variety of other market participants, including those in jurisdictions with high exposures to the LIBOR settings that will be subject to the exercise of the 23(D)(2) power. This would likely involve cooperation among authorities internationally and a related public communications strategy to raise awareness of the consultation.
7. The consultation should take place, and resulting policy decisions announced, as early as possible in 2021 so that there is maximum time for the market to prepare before the end of 2021.

Q2: How should we evaluate the practicality of transition and the scale of "tough legacy"?

8. The FCA sets out its interpretation of the term "tough legacy" in paragraph 2.7 and notes in paragraph 2.8 that it is not seeking feedback on this point. ICMA has therefore not addressed this point in this response, but is looking forward to responding to the forthcoming FCA consultation in relation to the exercise of the FCA powers under Article 23C of the Financial Services Bill (pursuant to which the FCA may permit some or all legacy use of an Article 23A benchmark by UK supervised entities).
9. The FCA states in paragraph 2.10 of the consultation paper: "First, evidentially, how should we assess the practicality of transition by the counterparties, and how many "tough legacy" contracts or instruments are likely to exist? We propose to look at public and non-public data which could help to identify the amount of outstanding legacy contracts and their duration, the nature of the contracts and the practicability of amending them in a fair way by mutual agreement or other contractual mechanism, and other relevant information which could evidence the effect in relevant jurisdictions of any intervention."
10. This approach sounds broadly sensible. In the bond market, the practicality of active transition by the counterparties will depend on a number of factors including:
 - (i) whether the bond was privately placed or distributed publicly (which will have implications for the likely number and variety of investors who need to be contacted and from whom consent will need to be obtained);

- (ii) the structure (eg in certain securitisations in which the original parties may no longer be active and therefore without a decision-maker); and
- (iii) whether the bonds have US-style consent thresholds (requiring unanimous consent of bondholders, which is almost impossible to reach in practice for bonds distributed publicly) or Euromarket-style consent thresholds, which may also be impractical to achieve in certain cases.

It is worth emphasising that, even in the context of a bilateral negotiation (which would be more straightforward than the situation for a publicly distributed bond), it may not be possible for the parties to reach an agreement on active transition. Moreover, it is possible that certain stakeholders could deliberately seek to be uncooperative in order to force an outcome that they consider to be more commercially attractive, or from which claims might be launched and damages sought.

11. The FCA should also consider (a) the costs associated with active transition in different asset classes (and which party or parties bears those costs); (b) how long active transition takes (eg in the case of consent solicitation in the bond market, each bond needs to be transitioned separately); and (c) how it will approach instruments with call options that can be exercised before maturity (in many cases, there would be an expectation that the issuer will exercise the call option, but this is not guaranteed, in particular for capital instruments).
12. We assume that the reference to the “other relevant information which could evidence the effect in relevant jurisdictions of intervention” will include a consideration of how the exercise of 23D powers will interact with any “tough legacy” legislation introduced in other jurisdictions such as the US/NY and the EU.

Q3: Do you agree that the scale of “tough legacy” must be significant in order to justify intervention?

13. The “significance” of “tough legacy” should not be determined solely on the grounds of scale in order to justify intervention. Other factors to take into account include the risk of market disruption and litigation if the authorities decide not to intervene, as envisaged in paragraphs 2.13 – 2.15 of the consultation paper.
14. In relation to scale, it is important that the “significance” of the scale of “tough legacy” is considered across all products and all markets that could be impacted, and the FCA should exercise its powers if the scale of “tough legacy” is significant in one or more of those product areas/markets. For example, even though bond market exposure is much smaller than derivative market exposure to LIBOR, that should not mean that the overall “tough legacy” problem is considered to be insignificant such that it does not justify intervention.

Q4: Under what circumstances might orderly transition be achieved without the use of Article 23D powers?

15. In the case of the bond market, an orderly transition is likely to depend on the use of Article 23D powers or some other form of legislative intervention as envisaged in other jurisdictions, for the reasons set out in the RFRWG [Paper on the Identification of Tough Legacy Issues](#) of May 2020.

Q5: Do you have any views on how we intend to consider whether intervention is desirable?

16. Yes. In relation to “Orderliness” noted in the first bullet point of paragraph 2.20, it is very important that the FCA considers how best to avoid the risk of market disruption and litigation among market firms.

Q6: Do you think we have identified all the relevant factors [related to how the FCA would use its 23D powers]?

17. Under “Least disturbance or disadvantage to affected parties” another point to consider is that the modifications should be as limited as possible in order to result in a benchmark that is as similar as possible to the previous benchmark, and at the least ensure that the way in which the rate is presented on the relevant screen page and how relevant market participants can reference it remains the same.

Q7: Are there any further issues which we need to consider in our approach to using our powers?

18. Please see our general remarks in paragraphs 1 – 5 above.

ANNEX

From Hansard for 17 November 2020

OPENING STATEMENT BY PAUL RICHARDS, ICMA, TO THE HOUSE OF COMMONS PUBLIC BILL COMMITTEE ON THE FINANCIAL SERVICES BILL

I hope to be able to give you a bond market perspective on the Bill but, for the market as a whole, we are all trying to move away from LIBOR to risk-free rates while minimising the risk of market disruption and litigation. The Bill is welcome and very important for the bond market because it will give the FCA extra powers to deal with tough legacy LIBOR contracts and wind them down in an orderly manner.

There are three main points on which it would be very helpful if the Committee was willing to strengthen the Bill. First, the Bill needs to provide continuity of contract between the current definition of LIBOR and the new definition of LIBOR for legacy transactions once LIBOR is prohibited for new transactions. Legacy contracts referencing LIBOR under the current method of defining LIBOR need to be read as references to LIBOR under the new definition as determined by the FCA, so that there will be continuity there – this is sometimes called a deeming provision. This will reinforce the message that LIBOR will continue to appear on the same screen page, and it should also help to remove uncertainty and minimise the risk of a legal challenge on the basis that the current definition of LIBOR and the new definition are not the same and one party or another is worse off.

This is particularly a risk in the bond market in cases where LIBOR is specifically defined in legacy bond contracts in terms of its current definition. Continuity of contract or deeming provision like this was used when the euro was launched in 1999, and it worked well. Clearly, it would need to be drafted with the help of the Treasury and it would probably need to be drafted in terms of an article 23A benchmark in the way that the Bill is looked at. That is the first point.

The second and related point on which I hope the Committee will help is that the provision of the continuity of contract under the Bill needs to be accompanied by a safe harbour against the risk of litigation. This would provide that the parties to contracts would not be able to sue each other as a result of the change in the definition of LIBOR, and it would allow them to make conforming changes to bond market documentation.

The third point on which I hope the Committee will help is that the safe harbour and contract continuity provisions in the Bill need to be drawn as widely as possible, to protect any entity that uses the new definition of LIBOR for legacy transactions in place of the current definition of LIBOR. This would need to cover not just supervised entities in the Bill, but non-supervised entities, as the range of institutions involved in the international bond market is very wide.

Finally, I would like to draw your attention to two other points where there are significant legal risks under the Bill. One is that there needs to be equal treatment between legacy LIBOR bonds when the new definition of LIBOR takes over from the current definition, so that some legacy bonds are not preferred to others and there is no discrimination between them; otherwise, legal problems may arise. This would be a matter for the FCA under the Bill.

The other point is that there needs to be alignment internationally between the Bill and the similar legislation that is being introduced in the US and the EU, so that the rate used for legacy dollar bonds under English law and legacy dollar bonds under New York law is the same. Thank you, Mr. Davies. I would be very happy to do my best to answer your questions.