

FCA consults on the proposed tough legacy powers

AT A GLANCE

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What's new?

- The Financial Conduct Authority (FCA) [published](#) a consultation and accompanying [statement](#), on 18 November 2020, on the new powers proposed [under](#) the Financial Services Bill (2020).
- The draft legislation gives the FCA tools to deal with so-called 'tough legacy contracts' that have no genuine alternatives to LIBOR and no realistic ability to be renegotiated or amended.
- On the same day, ICE Benchmark Administration (IBA) [announced](#) that it will soon consult on its intention to cease the publication of certain widely-used LIBOR settings after 31 December 2021.

What does this mean?

- Before the planned cessation of LIBOR at the end of 2021, market participants are expected to transition away from LIBOR-referencing contracts or otherwise amend them to include suitable triggers and fallbacks.
- With this in mind, the draft FS Bill amends the UK's retained version of the EU's Benchmarks Regulation (UK BMR) in relation to the FCA's powers on LIBOR transition.
- The Bill enables the FCA to 'designate' an unrepresentative benchmark. This means that it can change the rules, code of conduct and methodology of a critical benchmark in a way that it is no longer reliant on panel bank submissions.
- The FCA seeks views on how it will require continued publication of critical benchmarks on the basis of a changed methodology and, separately, in what circumstances they will be used - i.e. the situations in which a benchmark will be designated.

Designation of unrepresentative benchmarks (art. [23A](#) UK BMR)

- The FCA has the power to designate an unrepresentative benchmark if it cannot be restored or maintained.
- The reasons to do so include supporting the orderly wind down of a benchmark and preventing market disruption, but the FCA is asking opinions on the potential scenarios and conditions from market participants.

Continued publication on the basis of a changed methodology (art. [23D](#) of UK BMR)

- To use this power, the FCA notes that the LIBOR currency-tenor settings must be:
 - widely used in outstanding contracts (including by those outside of the UK); and
 - cannot be transitioned, renegotiated or amended.
- The use of powers will also need to contribute to protecting consumers and preserving market integrity.

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- The FCA will direct IBA to change the input data for LIBOR in order to sustain the critical benchmark.
- The FCA expects to exercise the powers in the most heavily used sterling currency-tenor settings and will continue to assess the case for the yen and US dollar LIBOR settings.
- It does not expect that the conditions are met for the euro and Swiss franc settings.

IBA consultation

- The IBA separately announced that it will soon begin a consultation process on its intention to cease the publication of all GBP, EUR, CHF and JPY LIBOR settings.
- It will make a further announcement regarding USD LIBOR at a later date.
- IBA highlighted that its announcement is not a confirmation that it will continue or cease the publication of any LIBOR settings at the end of 2021.
- The International Swaps and Derivatives Association (ISDA) also issued a statement to [underline](#) that the above action will not constitute an index cessation event under the [recently published](#) IBOR Fallbacks Supplement or the Protocol.

What do firms need to do?

- The announcements from the FCA and IBA do not change the importance or need of timely and active transition and adherence to relevant fallback arrangements where available.
- There has always been an advantage for firms to retain control over the terms in which they transfer their products away from LIBOR.
- Furthermore, many unknowns remain around tough legacy, what it will mean in practice, the timeline and which currency tenor pairs and instruments it will apply to.
- We expect the policy to provide more light into these questions at a later date.
- Finally, the announcements do not address the international comparison and what the practical implications between jurisdictions will be for market participants.
- Read more on tough legacy from our recent [publication](#) on the FS Bill.

Next steps

The FCA consultation runs until 18 January 2021. FCA will later publish a Statement of Policy. In addition, the FCA will run another consultation on other aspects of its new powers in Q2 2021 and will also undertake a second consultation on the way it will determine the changes to a critical benchmark.

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