

FCA consults on tough legacy powers - take two

AT A GLANCE

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What's new?

- The FCA [published](#) a consultation paper on 20 May 2021, asking for views on how it intends to use its so-called 'tough legacy powers' in relation to a critical benchmark (such as LIBOR) which is wound down, and the approach to prohibit the benchmark's use in new contracts.*
- Under the UK Benchmarks Regulation (BMR), the FCA has new powers to address the issue of legacy contracts which have no genuine alternatives to LIBOR and no realistic ability to be renegotiated or amended.
- The consultation is particularly relevant to some GBP, JPY and USD LIBOR settings, which have been confirmed as becoming permanently unrepresentative.

What does this mean?

- The FCA [published](#) its policy framework in March 2021, setting out how and when it would use the powers to require continued publication of LIBOR on a synthetic basis.
- The latest consultation sets out a non-exhaustive list of factors the FCA considers relevant in deciding: what type of products or legacy LIBOR-based contracts - and to what extent - should be allowed to reference synthetic LIBOR, and the proposed approach for prohibiting the use of LIBOR in new contracts.
- The relevant factors are likely to include: if appropriate alternative benchmarks are available, the practicability and likelihood of transitioning contracts, and the sophistication of parties involved.
- The FCA will also consider whether the prohibition on use would affect parties differently and create misaligned incentives to amend the contract on fair terms. An example of this could be where not all contract parties are subject to the UK regulation.
- The FCA will also look into factors including international consistency, available fallbacks, the impact on risk-free rates and the FCA's ability to set clear and practicable criteria for the market.
- The legacy use may only continue for a limited time or in a limited form.
- The powers under BMR allow the FCA to compel publication of synthetic LIBOR for up to ten years, reviewed annually. The FCA has previously indicated its plans to end JPY synthetic LIBOR publication after one year, in December 2022.

Permitting legacy use of LIBOR (art. 23C BMR)

- To permit legacy use after loss of permanent representativeness, the FCA proposes to assess the scale and nature of contracts.
- The regulator then plans to consider the existing barriers and practical feasibility for parties to amend LIBOR-referencing contracts in a way which delivers fair outcomes.

*As LIBOR is currently the only critical benchmark in the UK, we will refer to LIBOR instead of 'critical benchmark' throughout.
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Restricting new use of LIBOR (art. 21A BMR)

- This relates to USD LIBOR, as some settings will continue in their current form until mid-2023.
- The FCA has already confirmed that it “supports the US authorities’ approach of stopping new use of dollar LIBOR by the end of this year.”
- The paper lists potential consumer protection and integrity risks if the FCA does not use the power. These include: risks to operational resilience, financial stability, volatility / liquidity impacts and the likelihood of the rate becoming unrepresentative.
- The FCA would also consider whether there is adequate liquidity in alternative benchmarks and market preparedness to use them.
- The restriction could only apply to certain contract maturities, or types of products / users, or come into effect after a defined time period.
- In addition, the FCA proposes that it will not intervene where the new use is aimed at risk management of legacy exposures or where suitable replacement benchmarks are not yet available for use.
- As before, the FCA will take into account international consistency and the ability to set out clear and practicable criteria.

What do firms need to do?

- Given the limited time left, the short notice firms are likely to get around synthetic LIBOR and the expected limitations on use, ensuring rapid progress is essential.
- This should include a revalidation of the effort to complete remaining work, including the dependence on third parties, and ensure delivery can be completed within the remaining time and budgets.
- Firms should critically review their plans in the light of the consultation paper to ensure downside risks are understood and their programmes have not made unduly optimistic assumptions on regulatory or legal solutions.
- All market participants, including those who are not within scope of BMR (such as non-UK firms and non-financial corporates), should also consider the potential impact of synthetic LIBOR publication on those contracts which state that fallbacks will only operate when LIBOR ceases permanently.

Next steps

The consultation runs until 17 June 2021. The FCA plans to publish a Statement of Policy in Q3 2021.

The FCA will consult in Q3 2021 on its proposed decisions on precisely what legacy use it will allow for any synthetic GBP and JPY LIBOR, and how it might restrict new use of LIBOR rates, including USD LIBOR. The FCA will confirm its final decisions in Q4 2021.

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