

HMT proposes a safe harbour for certain LIBOR-referencing contracts

AT A GLANCE

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What's new?

- HM Treasury (HMT) [published](#) a consultation paper on a supplementary legal 'safe harbour' in respect of LIBOR-referencing 'tough legacy' contracts on 15 February 2021.
- The paper follows the FCA's previous [consultations](#) on its new proposed powers [under](#) the Financial Services Bill (2020) (Bill).
- HMT proposes a legal 'safe harbour' to minimise litigation risk for 'tough legacy' contracts referencing critical benchmarks (i.e. GBP LIBOR) where the FCA causes a methodology change to those benchmarks (so-called 'synthetic LIBOR') under its new powers.

What does this mean?

- Before the planned cessation of LIBOR at the end of 2021, firms need to transition away from LIBOR-referencing contracts or otherwise amend them to include suitably robust triggers and fallbacks.
- In order to minimise the disruption from LIBOR transition, the draft Bill amends the UK Benchmark 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 designation would create 'synthetic LIBOR'.
- In November 2020, the FCA asked for views on the continued publication of critical benchmarks on the basis of a changed methodology and in what circumstances they will be used.
- HMT notes that a number of stakeholders approached it to propose the inclusion of a legal 'safe harbour' for legacy contracts referencing synthetic LIBOR.
- In particular, stakeholders have noted that the designation and methodology change of a critical benchmark should not:
 - discharge or excuse the performance of a contract
 - give the right to unilaterally terminate or suspend performance of a contract
 - give rise to liability for a facility or calculation agent
 - constitute a breach of, void, amend, modify or novate a contract.
- HMT now seeks views on whether it should introduce a safe harbour legislation, and what the rationale and scope of it would be.
- According to HMT, the legislation would reduce the potential risk of contractual uncertainty and legal disputes in relation to synthetic LIBOR-referencing contracts.

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Rationale for safe harbours

- HMT is keen to understand, on the basis of strong evidence, the potential litigation risks involved with the FCA's new benchmark designation powers and how a safe harbour could be used to reasonably minimise the risk.
- It also reminds market participants that not all eventualities can be specifically legislated for.

Scope of safe harbours

- HMT also seeks views on its proposed approach for the safe harbour to cover contracts where the law of England and Wales is the choice of law, regardless of the jurisdiction of the parties to the contracts.
- HMT proposes that the safe harbour should extend to those contracts that sit outside of the definition of 'use' and those not entered into by 'supervised entities', as defined in the UK BMR.
- HMT notes that the safe harbour provisions should equally apply to contracts that are entered into in breach of the Bill's provisions precluding use of a benchmark once designated under its new powers.
- HMT states that the safe harbour provisions would not seek to override suitable contractual fallbacks.

Administrator immunity

- HMT considers that a benchmark administrator should not be subject to litigation from administering a benchmark designated by the FCA, and seeks respondents' views on such a safe harbour.

What do firms need to do?

- The consultation is welcome news to market participants. It promotes an element of legal certainty and seeks to prevent claims brought by parties whose contracts incorporate a designated benchmark.
- The consultation may also encourage active transition, as pursuing possible court action for tough legacy contracts would be blocked.
- However, the contracts and circumstances subject to the tough legacy powers are yet to be defined.
- Firms, particularly where they are not established in England and Wales, should consider responding to the consultation.
- For further background, please see our previous publications on the FCA's [consultation](#) on tough legacy and the FCA's proposed new powers as [introduced](#) under the Bill.

Next steps

The HMT consultation runs until 15 March 2021. The FCA will later publish a Statement of Policy of the intended use of its new powers. In addition, the FCA is expected to run further consultations on other aspects of its new powers in Q2 2021.

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