The FCA
FCA Head Office
12 Endeavour Square
London E20 1JN

The Investment Association
Camomile Court, 23 Camomile Street,
London, EC3A 7LL
+44 20 7831 0898
@InvAssoc The Investment Association

Email to: benchmark-article23A@fca.org.uk
benchmark-article23D@fca.org.uk

18 January 2021

RE: Consultations on proposed policy with respect to the designation of benchmarks under new Article 23A and the exercise of the FCA's powers under new Article 23D

The IA has worked with its members to outline a short list of points in response to the FCA's two consultations. We note the short deadline for producing responses to these consultations, exacerbated by the Christmas and New Year breaks during this period. As such, some of our concerns are provisional.

Our industry's key ask is for clarity and consistency in the regulator's approach to exercising its new powers, including when designating a critical benchmark, appointing definitions and policy, taking decisions and setting deadlines. Clarifying the interplay with IBOR transition processes in other jurisdictions is also critical.

We specifically encourage the FCA to provide as much time as possible for stakeholders to consider and respond to any consultation on any prospective decisions to exercise intervention powers. This will give stakeholders more time to submit a considered response and allow time for any necessary engagement with counterparties and clients.

The 23A Consultation

We are generally supportive of the factors currently flagged, and the fact that this consultation forms part of a wider consultation process, with more targeted consultations on specific elements of the legislative policy and individual rates to be forthcoming, particularly the proposed Article 21A and Article 23C and a further consultation in relation to any decision to exercise the proposed Article 23D power in respect of LIBOR.

We see this process as helpful in providing signalling to the market and establishing relevant timeframes.

We would welcome more clarity from the FCA on the potential timeline and a decision tree of likely outcomes with next steps following the consultation. It would be particularly useful to understand the anticipated interplay with other relevant global consultation processes, such as those being run by the IBA. Overall, the greater the certainty on these issues, the more the market can prepare for the changes, and the less disruption there will be.

We would also welcome tailored guidance for investment managers and buy-side firms, where this is applicable.

Q1: Do you agree with the factors that we plan to consider when determining whether we can designate a benchmark as an Article 23A benchmark?

Q2: Do you agree with the factors that we plan to consider when determining whether we should designate a benchmark as an Article 23A benchmark?

While we generally agree with the factors that the FCA will consider, we would suggest some further elements for consideration around how such designation would impact the market and index users:

- Finalising and publishing the definition and analysis of the 'tough legacy' universe: while this is the subject of the related 23D consultation, any decisions around 'tough legacy' should be announced to the market in good time and well in advance of any designation occurring, to enable the necessary related planning and internal portfolio analysis to be undertaken by market participants. We do not consider that the FCA would be able adequately to assess the impact on the market and market participants without first finalising and publishing its definition and analysis of the 'tough legacy' universe.
- It would help the market if the FCA were able to provide information and details about how it plans to interact with global regulators about any steps taken prior to the announcement of any designation, or in determining an alternative methodology.
- We would also appreciate clarification of the nature of the FCA's locus to compel third country panel banks to continue to make submissions (e.g. is there a scenario where panel banks could seek to stop submitting prior to, for example, June 2023 for USD LIBOR?)
- We would encourage the FCA to confirm any alternative methodology proposed for various LIBOR tenors as soon as possible, particularly where it has already formulated or narrowed down potential models for this. To the extent the expected methodology differs from market accepted fallback rates (such as the ISDA fallback models or synthetic LIBOR), the FCA should provide information about the reason for any variation and provide sufficient time for market participants to amend positions affected accordingly. It has been suggested that a minimum timeframe of three months would be required. In making these decisions, the FCA should liaise closely with, and be guided by, the home country regulators for the relevant currencies and consider any variations required for different asset classes.

Q3: Do you think there are any additional factors that we should take into account?

In relation to the prohibition on use that would be triggered on a designation occurring – does the FCA envisage a time period between the non-representative announcement and the prohibition on use occurring? It would be a concern, from a market readiness perspective, if this was too short. It has been suggested that a minimum timeframe of three months would be required.

The 23D Consultation

As there is a clear path to LIBOR cessation, based on the IBA consultation, which is also consistent with the 'Market Lead' approach that UK regulators have said is how the transition should be managed, we would be reluctant to see the FCA using these powers between now and the end of 2021. From a 'market lead' perspective, it is critical that the FCA conduct sufficient consultation with the market on any appropriate replacement or revised calculation.

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?

As suggested in para 1.13, we are supportive of the FCA consulting broadly and globally in understanding 'tough legacy' issues. We would welcome FCA engagement on each of the elements outlined in the current consultation paper, including the constituent items relating to the reasons underpinning the FCA's decision to use the powers and an explanation as to how the FCA would intend to exercise the powers.

On that basis, we would also encourage regulators to engage to formulate a globalised solution, in so far as possible, in relation to a 'tough legacy' population, ideally ahead of public consultation, given the number of challenges already embedded in this transition process. The idea that various regulators will choose different methods of approaching 'tough legacy' would introduce an additionally burdensome element of uncertainty to the process. We would therefore encourage consistency, in so far as possible, between at least the UK and US approaches.

In terms of timing, we welcome the fact that the FCA will seek to exercise its intervention powers in a way that "causes least disturbance or disadvantage to affected parties" and would suggest that this approach is extended to consider the consultation process. While acknowledging the relevant timescales set out in the draft legislation, we would encourage the FCA to provide as much time as possible for stakeholders to consider and respond to any consultation on any prospective decisions to exercise intervention powers. It has been suggested that a minimum timeframe of three months would be required. This will give stakeholders more time to submit a considered response and allow time for any necessary engagement with counterparties and clients.

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

We would encourage the FCA to be transparent with the data set it is using for these conclusions and disclose this as part of their policy document or via future consultation processes. (NB: regarding the USD LIBOR announcement re the extension to 2023, the ARRC stated that the basis for that change was that they believed most contracts would have rolled off by this date. This calculation was done based on notional values. We are struggling to find any details of how these figures were derived and they are not representative of members' legacy books, which is concerning). We would also suggest the information should be broken down between cash products and other asset classes, to make clear the basis on which such analysis and decision making is done.

As regards evaluating the scale of 'tough legacy', the FCA should consider issuing definitive guidance or a program around 'tough legacy' which would allow market participants to identify in a consistent manner the existence of such contracts. Currently, market participants are undertaking to identify 'tough legacy' contracts without a consistent view as to the specific qualifying criteria. For example, if a LIBOR-based contract is silent with respect to what happens when LIBOR is discontinued (that is, it has no fallback language) and the contract requires unanimous investor consent for amendments, it is unclear if the contract would qualify as 'tough legacy' or whether the contract would only be considered 'tough legacy' once the issuer undertakes a consent solicitation exercise that fails to gain investor approval.

This ambiguity has resulted in significant duplication on the part of market participants leading to wasted resource. If the FCA were to issue definitive guidance or establish an identification program with a definition or parameters of a 'tough legacy' contract, the evaluation of the scale of 'tough legacy' would lead to a material administrative alleviation for market participants. It would also allow market participants to better understand the population of contracts that are 'tough legacy', and for which reliance on a legislative solution may be necessary.

As noted above, we would strongly urge that there should be a reasonable time period between a designation occurring and the prohibition on use occurring. It has been suggested that a minimum timeframe of three months would be required. It would be a concern, from a market readiness perspective, if this prohibition were too soon.

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

We do not agree that the scale of 'tough legacy' must, *necessarily*, be significant to justify FCA intervention.

The draft UK BMR Article 23D(3) states the two criteria which must both be met in order to exercise the proposed new powers granted under that Article. The criteria include that the FCA must exercise its proposed new powers in order to advance either or both of its statutory objectives to protect consumers and to protect and enhance the integrity of the UK financial system. By requiring that the scale of 'tough legacy' be 'significant' (for which there is no definition, or threshold) in order to justify intervention, the FCA could be failing to meet either of these statutory objectives. It is not clear that by introducing a significance threshold the FCA would protect customers who hold legacy LIBOR assets or have investments in funds holding legacy LIBOR assets. The outcomes for such assets are characterised by a high level of uncertainty, in light of LIBOR ceasing.

Where counterparties, despite their best efforts, are unable to resolve 'tough legacy' contractual issues, the only way to protect consumers and uphold market integrity is for the FCA to intervene. To operate on the basis that the FCA can only intervene where the scale of 'tough legacy' is 'significant' would serve only to crystallise the potential for harm for counterparties entered in 'tough legacy' contracts that do not meet this threshold, undermining the policy intention behind granting the FCA new intervention powers.

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

Despite the best efforts of market participants and the extensive steps taken to ensure the orderly resolution of issues relating to critical benchmark cessation thus far, it is unlikely that all issues relating to 'tough legacy' contracts will be resolved through the actions of market participants alone.

A good way to assist an orderly resolution would be to formulate clear timelines for transition away from products and asset classes and communicate these to the market in good time to encourage transition efforts. We are hopeful that, with the ISDA Protocol becoming effective, issuers and other market participants will be able to take more active transition steps for the remaining asset classes. As set out above in relation to market interventions, the regulator should be more prescriptive for UK issuers, to get them moving down the consent solicitation route.

It would be beneficial for the FCA to put pressure on issuers to ensure that they proceed with the consent solicitation process - notwithstanding the potential availability of a synthetic LIBOR rate.

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

While we agree with the criteria as set out in the proposed UK BMR Article 23D, we note the FCA's acknowledgement that it can only exercise its proposed new powers in order to advance either or both of its statutory objectives to protect consumers and to protect and enhance the integrity of the UK financial system. We re-iterate our view that it would be inappropriate to base intervention on 'significant' scale only.

Q6: Do you think we have identified all the relevant factors?

In addition to the factors set out in the consultation, we consider that the FCA should consider prohibiting the issuance of any new contracts or instruments referencing synthetic LIBOR, as such contracts or instruments would be reliable in the long-term. There should be an exception to this, to allow market participants to enter into new contracts or instruments referencing synthetic LIBOR where the reason is to hedge tough legacy instruments which have moved to synthetic LIBOR.

In addition to the considerations listed in sub paragraphs 3.7.1-4, we suggest that the FCA should consider within the objective of "least disturbance or disadvantage to affected parties" ensuring sufficient lead time when communicating the use of these powers. It is critical that market participants have sufficient time to respond to any forthcoming FCA intervention, including communicating with counterparties and clients. It is also important for ensuring that "supervised entities" can continue to meet their obligations as set out under UK BMR Article 28(2).

The FCA should also ensure, to the extent possible, that any parallel communications from other regulators or the relevant benchmark administrator are coherent and consistent. This is particularly important in the context of any concurrent announcements with international regulators, hence we welcome the approach set out by the FCA in paragraph 2.17.

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

It would be beneficial to market participants if there is to be a minimum notice period between a decision to stop publishing synthetic LIBOR being made and the actual end of publication. This would ensure that any remaining users of the rate have a suitable amount of time to transition to another rate if they haven't done so already. Having said that, there needs to be a balance because the risk of a short or minimal notification period might serve as an incentive for issuers to push ahead with consent solicitations notwithstanding the availability (for the time being) of a synthetic rate.

We hope that all makes sense, but do let us know if you have any queries on any of the above.

Yours faithfully

Adrian Hood
Regulatory and Financial Crime Expert

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £8.5trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 40% of this is for overseas customers. The UK asset management industry is the largest in Europe and the second largest globally.