

MEMO# 32902

November 10, 2020

LIBOR Update: Your Feedback Requested on Draft Principles in Response to the UK Financial Services Bill and US Legislative Proposals for Tough Legacy Contracts

[32902]

November 6, 2020 TO: LIBOR Transition Working Group RE: LIBOR Update: Your Feedback Requested on Draft Principles in Response to the UK Financial Services Bill and US Legislative Proposals for Tough Legacy Contracts

As you know, the UK Government introduced a bill in Parliament that would provide the Financial Conduct Authority (FCA) with new powers resolve concerns about “tough legacy” contracts that would continue to reference LIBOR after it is discontinued or declared non-representative.^[1] Similarly, there have been discussions by Representatives in the US Congress to provide a tough legacy contract solution under US law.

Below are draft principles that we are considering to serve as a basis for feedback to UK and US policymakers regarding tough legacy contract legislation. **Please email any comments on these principles at bridget.farrell@ici.org by Thursday, November 12.**

UK Financial Services Bill

At a high level, the Financial Services Bill would allow the FCA to require a benchmark administrator to change how a critical benchmark, such as LIBOR, is determined, including the input data and the rules for the benchmark. In general, the FCA would allow the publication of this newly calculated LIBOR for use in tough legacy contracts that still reference LIBOR after that rate is discontinued or declared non-representative.

We are considering the following draft framework in responding to the Financial Services Bill:

- **Broad support:** We support solutions that address tough legacy contract issues while being narrowly tailored as not to unnecessarily override agreed-upon contractual language.
- **Take into account the recommendations of industry working groups:** The UK

approach would allow the FCA to require changes to the methodology for calculating LIBOR. This approach may lead to confusion outside the UK about whether the new LIBOR rate can continue to be used in contracts and financial instruments. To minimize the impact of that confusion, the UK approach should ensure that the replacement calculation methodology for any currency of LIBOR takes into account the rate that has been used in that currency's home market and recommended by the risk free rate working group in that currency's jurisdiction. This change will reduce the differences between the UK approach and those approaches proposed in the EU and other jurisdictions, even if there remains confusion about the extraterritorial application of the UK's new LIBOR rates.

- **Define “tough legacy” contracts or financial instruments to exclude legacy contracts that already have agreed-upon fallback language that does not reference LIBOR.** Consistent with the ARRC's approach in its New York State proposed legislation, the UK should add a definition of “tough legacy contract” to ensure that any newly-calculated LIBOR rate would not be applied to contracts or financial instruments that already contains agreed-upon fallback language that itself does not reference LIBOR.
- **Consider grandfathering contracts or financial instruments that are modified for benchmark transition:** In order to minimize impact on taxation or financial reporting, add language clarifying that any contract or financial instrument that is modified by the operation of this bill, if enacted, would not create a new contract or financial instrument.
- **Support extension of the transition period for third country benchmarks until end-2025.**

Potential US Legislation

ICI would consider the following draft framework in evaluating any potential legislation efforts in the US that would replace LIBOR in a tough legacy contract with a new benchmark rate recommended by a regulator or industry group upon a statement by a regulator or administrator that LIBOR is discontinued or non-representative:

- **Broad support:** We support solutions that address tough legacy contract issues while being narrowly tailored as not to unnecessarily override agreed-upon contractual language.
- **Trust Indenture Act:** We support a safe harbor from litigation under the Trust Indenture Act for tough legacy bonds that would transition to a replacement rate by operation of law, so long as the legislative language is narrowly tailored to only apply to LIBOR transition and would not apply to other circumstances that could override bondholder consent rights.
- **Trigger Events:** We would support legislative language that would make a reference rate replacement in a tough legacy contract, financial instrument, or security self-effectuating after a trigger event, such as a statement by the LIBOR regulator or administrator that LIBOR (or a particular tenor of LIBOR) is discontinued or no longer representative, without requiring further subjectivity or need for interpretation.
- **Scope of legislation:** To reduce confusion, the risk of litigation, and the potential for regulatory arbitrage, we recommend legislative language clarify that any law would apply to only contracts, financial instruments, and securities governed by the laws of the US or any of the states or territories within the US. Similarly, we recommend

legislative language stating that any federal-level legislation would preempt any conflicting state law.

- **Consider grandfathering contracts or financial instruments that are modified for benchmark transition:** In order to minimize impact on taxation or financial reporting, we recommend including legislative language clarifying that any contract or financial instrument that is modified by the operation of law would not create a new contract or financial instrument.

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endnotes

[1] See ICI Memorandum No. 32855, *available at* https://www.ici.org/my_ici/memorandum/memo32855. See also Financial Services Bill (Bill 200) (Oct. 21, 2020), *available at* <https://publications.parliament.uk/pa/bills/cbill/58-01/0200/200200.pdf>. See also Financial Services Bill Explanatory Notes (Bill 200-EN), *available at* <https://publications.parliament.uk/pa/bills/cbill/58-01/0200/en/200200en.pdf>; HM Treasury Policy Statement on Amendments to the Benchmarks Regulation to summer LIBOR transition (Oct. 2020), *available at* https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/928238/LIBOR_Policy_Statement.pdf. Currently, the FCA regulates LIBOR under the EU BMR, which has directly applied in the UK since 2018. The UK Financial Services Bill indicates that the UK BMR, which retains portions of the EU BMR, would take effect at the end of the Brexit transition period. See Explanatory Notes at paragraph 233. The Brexit transition period ends on December 31, 2020.