

MEMO# 33553

May 27, 2021

LIBOR Update: UK Financial Conduct Authority Issues Consultation on Tough Legacy and Use of Synthetic LIBOR

[33553]

May 27, 2021

TO: ICI Global Regulated Funds Committee

LIBOR Transition Working Group RE: LIBOR Update: UK Financial Conduct Authority Issues Consultation on Tough Legacy and Use of Synthetic LIBOR

Last week, the UK Financial Conduct Authority (FCA) issued a consultation soliciting feedback on which contracts and financial instruments it should permit to use "synthetic" LIBOR rates^[1] after those rates can no longer be used under their current calculation methodology. The consultation discusses whether to permit or prohibit use of synthetic LIBOR in tough legacy contracts that were entered into before LIBOR discontinuation as well as in new contracts that may be created after LIBOR discontinuation.^[2]

Responses to the consultation are due June 17, 2021. ICI is considering submitting a response. Please contact Bridget Farrell at bridget.farrell@ici.org with any questions or feedback.

Legacy Use

The FCA consultation solicits feedback on which legacy contracts and instruments should be permitted to use the synthetic version of a discontinued benchmark under BMR Article 23A. The FCA notes that it will make its determination on legacy use of synthetic LIBOR based on its consumer protection and integrity objectives.

The FCA identifies certain types of contracts that may be threatened if legacy use of synthetic LIBOR were to be prohibited, including contracts that:

- do not contain a fallback provision to allow the use of a reference rate when a benchmark can no longer be used; or
- contain a fallback provision to allow the use of an alternative rate, but that rate would be inappropriate (e.g., unintended, unfair, or disruptive) or inoperable.

The FCA also cautions contractual parties to note whether their contracts contain fallback language that would be triggered only when a benchmark, such as LIBOR, ceases

permanently. The FCA notes that such fallback language may not be triggered while a benchmark continues to be published as a synthetic rate.[\[3\]](#) The FCA contrasts this type of contractual fallback language with other fallback provisions that would be triggered upon a benchmark being deemed unrepresentative. The FCA believes such an unrepresentativeness trigger would effectively move the contract to the contractual fallback reference rate and not to a synthetic benchmark rate.

In considering which legacy contracts and instruments should be permitted or prohibited to use a synthetic rate, the FCA will consider, among other factors:

- Whether there are appropriate alternatives to legacy use of synthetic LIBOR and whether those alternatives would be fair and appropriate;
- The ease of amending a contract;
- The availability of mechanisms for changing large volumes of contracts;
- The nature of the parties to the contracts; and
- Whether permission to allow legacy contract use of synthetic LIBOR would change the incentives of contractual counterparties to amend a contract.

The FCA will also take into account whether its actions would be consistent with those of international counterparts. It acknowledges that lack of consistency globally might increase confusion and uncertainty rather than provide clarity, particularly for contracts that would be subject to the BMR but governed by the law of another jurisdiction.

New Use:

Although using a synthetic LIBOR rate in a new contract or instrument generally would be prohibited, the FCA also solicits feedback on whether or not to permit some new use of a synthetic benchmark rate under its powers in Article 21A of the BMR.

In doing so, the FCA would consider promoting its objectives of orderliness and consumer protection. In particular, FCA is considering circumstances where permitting some new use may be helpful in :

- managing down legacy exposures to the benchmark (e.g., where new use is needed to unwind an existing legacy exposure);
- mitigating other risks arising from legacy exposures to the benchmark (e.g., new use that maintains market participants' ability to risk manage a legacy exposure effectively); or
- ensuring users have access to suitable replacement benchmarks, including where there are alternatives available but not widely used enough to develop liquidity in markets referencing those alternative benchmarks.

The FCA also cites to the US Federal Reserve Board and prudential regulators' guidance to banks about LIBOR transition. That guidance, which cautioned against new use of LIBOR benchmarks after 2021, recognized "limited circumstances" for new use of LIBOR, including hedging, market making, and novations of existing LIBOR contracts.[\[4\]](#)

Bridget Farrell
Assistant General Counsel

endnotes

[1] Under the Benchmarks Regulation (BMR), the FCA has powers to change the calculation inputs and methodology for LIBOR, which is currently calculated based on panel bank submissions, to create a synthetic rate based on different inputs and methodology.

[2] See Benchmarks Regulation: how we propose to use our powers over use of critical benchmarks, Consultation Paper CP 21/15 (May 2021), *available at* <https://www.fca.org.uk/publication/consultation/cp21-15.pdf>.

[3] In the FCA's terms, while the rate remains a Article 23A critical benchmark, as designated by the FCA.

[4] Statement on LIBOR Transition (Nov. 30, 2020), *available at* <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20201130a1.pdf>.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.