LMA Loan Market Association

15 January 2021

BY EMAIL

Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Email: benchmark-article23A@fca.org.uk

Dear Sirs,

Consultation on proposed policy with respect to the designation of benchmarks under new Article 23A

The LMA welcomes the opportunity to respond to the consultation document entitled "*Consultation on proposed policy with respect to the designation of benchmarks under new Article 23A*", published on 18 November 2020 (the "**Article 23A Consultation**").

We have also submitted a response to the consultation published the same day on the proposed policy with respect to the exercise of the Financial Conduct Authority's ("**FCA's**") powers under new Article 23D (the "**Article 23D Consultation**").

The LMA is the trade body for the syndicated loan market in Europe, the Middle East and Africa. Its aim is to encourage liquidity in both the primary and secondary loan markets by promoting efficiency and transparency, as well as by developing standards of documentation and codes of market practice, which are widely used and adopted. Membership of the LMA currently stands at over 750 organisations across 69 jurisdictions and consists of banks, non-bank investors, law firms, rating agencies, borrowers, service providers, regulators and legislators, including the FCA.

The LMA welcomes the Financial Services Bill (the "**Bill**") and the proposed provisions which would allow an orderly cessation of a critical benchmark. We also welcome the FCA consultations on the proposed policies for exercising the FCA's powers under proposed Article 23A and Article 23D. Overall, the LMA agrees with the factors outlined in the Article 23A Consultation that the FCA plans to consider when determining whether it can, and whether it should, designate a benchmark as an Article 23A benchmark. However, we consider that there are also other factors that should be taken into account. We have detailed these factors below.

Our member institutions are likely to have other thoughts on the Article 23A Consultation and we have encouraged them to submit their own feedback.

Prohibition on use of the benchmark

The designation of a benchmark as an Article 23A benchmark would result in an automatic general prohibition on use of the benchmark by supervised entities. Given the automatic nature of the consequences, the impact of this prohibition in the context of contracts which involve entities which are not UK supervised entities needs careful consideration. If there is a prohibition on use for UK supervised entities, but other entities (e.g. non-supervised UK entities or non-UK entities) can still use the benchmark, this could cause contractual uncertainty, implications for related contracts and an unlevel playing field. International coordination will be important in this context.

For example, in the context of a syndicated loan transaction, there may be lenders which are entities incorporated or regulated in any number of jurisdictions. If a UK supervised entity was within the scope of Article 23B as set out in the Bill and was unable to use the benchmark (for example, to hedge its exposures under the loan), this may raise questions of whether the benchmark could continue to be referenced in a contract to which that UK supervised entity and other syndicate lenders not subject to the same restriction were party.

Permitted legacy use

The Bill provides powers for the FCA to exempt some or all existing use of the benchmark from the general prohibition noted above. This is helpful in the context of the need to address the position of so called “tough legacy” contracts or instruments for which such transition is not practicable. However, it needs to be clear what "tough legacy" actually means and what is not practicable. Without this clarity it is not possible to determine how the designation of an Article 23A benchmark will impact the financial market. Whilst we understand that the use of this power will be the subject of further consultation, we consider that this needs to be factored into the decision to designate a benchmark as an Article 23A benchmark given the automatic nature of the consequences of such designation.

It is acknowledged that the FCA would consider whether the designation would be appropriate to enable the FCA to support the orderly wind-down of a benchmark. We would encourage the FCA to consider whether such designation would lead to a practical transition to a replacement rate, particularly for contracts that cannot practicably be transitioned away by agreement (i.e. "tough legacy" contracts), and whether this would mitigate disputes and provide market clarity. For tough legacy contracts, it will be important to have clarity on whether the FCA would use its powers upon a designation to provide a solution for such contracts in order to achieve an orderly wind-down of a designated benchmark. Therefore designation also needs to be considered alongside the FCA's powers under Article 23D to require changes to a critical benchmark, including its methodology. Please see our response to the Article 23D Consultation.

We would welcome clarification as soon as possible of the approach that the FCA will take in relation to permitting continued use of LIBOR in legacy contracts. In particular, it will be necessary to give careful consideration to the potential impact on related contracts if continued use of LIBOR is only permitted for certain types of contracts or counterparties (for example, if continued use of LIBOR is possible in wholesale loans, because this is not "use" for the purposes of the BMR, but not possible in related hedge contracts).

Administrator intention to cease publication

The Article 23A Consultation notes that the FCA might consider that it is not appropriate to designate a benchmark as an Article 23A benchmark, even though the qualifying conditions are met. The example is given of the administrator of the benchmark making clear its intention to cease publication of the benchmark within a reasonable time period. In this case the FCA might consider that the cessation of the benchmark over the time period planned would not have a disorderly impact on the market and therefore, that designation was not required.

In this context, it is noted that ICE Benchmark Administration Limited published a consultation on 4 December 2020 of its intention to cease publication of: (i) GBP, EUR, CHF, JPY LIBOR rates across all tenors and the 1-week and 2-month USD LIBOR settings after 31 December 2021; and (ii) the remaining USD LIBOR settings after 30 June 2023. The consultation closes on 25 January 2021, with the results expected to be announced shortly thereafter. Given this ongoing consultation, the proposed policy raises the question of what the FCA considers to be a reasonable time period. In assessing a reasonable time period and the ability of the parties to meet this time period, we consider that the FCA also needs to factor in the scale of the use of the benchmark, and the practicality of transition.

In terms of assessing practicality of transition, we would reiterate the points made in the "*Paper on the identification of Tough Legacy issues*" published by the Working Group on Sterling Risk-Free Reference Rates (the **"£RFR WG**") in May 2020 which notes considerations impacting practicality of amendments. For example, in the context of the loan market, the very large number of bilateral and syndicated loan contracts, the diverse nature of the borrowers, questions of cost, resource availability and other challenges to transition (e.g. creditor standstills, financial restructurings or insolvency proceedings) means that the renegotiation of all these contracts on an individual basis ahead of end-2021 creates practical difficulties for market participants.

International and multicurrency considerations

Given the international use of LIBOR and international aspects of many financial products, it is important that the FCA have regard to the impact of any designation of an Article 23A benchmark beyond English law contracts or UK counterparties. In particular, the impact on and interaction with legislative solutions in other countries which could be triggered by such designation should be factored in. For example, there are proposals for legislative solutions to the cessation of benchmarks in both the US and the EU. At the very least, it will be necessary to ensure that there will not be a multiplicity of scenarios which could apply to a given situation as contractual certainty is key.

We hope that you will find our feedback constructive. We would be pleased to discuss any aspect of the above with you in more detail. If we can be of any further assistance please do not hesitate to contact me by email at clare.dawson@lma.eu.com or on 020 7006 6007).

Yours faithfully,

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