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BY EMAIL

Market Conduct Unit

Securities and Markets

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Dear Sirs,

HM Treasury Consultation - Supporting the wind-down of critical benchmarks

The LMA welcomes the opportunity to respond to the consultation document entitled "*Supporting the wind-down of critical benchmarks*" (the "**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 HM Treasury's work engaging with the industry and in preparing the Consultation in order to assess the rationale and scope of any potential safe harbour.

We have not sought to respond to each element in the consultation, but have set out our thoughts on the key relevant areas for the syndicated loan market below. Our member institutions are likely to have other thoughts on the Consultation and we have encouraged them to submit their own feedback.

Rationale for any legal safe harbour provisions

Question 1: If a critical benchmark is designated as an Article 23A benchmark, and subject to a possible change in methodology under Article 23D, how might this create contractual uncertainty?

Question 2: Subject to responses to the previous question, would this contractual uncertainty lead to causes of action, potential liabilities or grounds for litigation, between parties to contracts or between other parties? If yes, please specify:

- **The nature of the causes of action, liabilities or grounds for litigation that could arise;**
- **How likely they would be, the circumstances and the likely timing in which these could arise;**
- **Possible impacts (quantitative and qualitative) on contractual parties and the wider market.**

We consider that a legal safe-harbour would be useful, as there is still uncertainty around whether references to LIBOR (or other benchmarks) in documentation would be interpreted as references to a benchmark that is labelled LIBOR and available in the same way as current LIBOR but which is calculated in a materially different way. In this context, we note that new Art 23D UK BMR would give the FCA the power to impose requirements on the administrator of a designated benchmark relating to the way in which the benchmark is determined, and that this power is not limited by the market or economic reality that the benchmark was originally intended to measure. As a result, it seems likely that where the FCA designates a benchmark and requires the administrator to make changes to its methodology, this would involve material changes to the benchmark.

Similar issues may also arise in relation to the proposed prohibition under Art 23B on use of a designated benchmark by supervised entities, and the ability for the FCA to permit some or all legacy use under Art 23C. If it is unclear whether or not a benchmark can continue to be referenced in a contract, this will raise similar issues of uncertainty around how to interpret references to LIBOR (or other critical benchmarks) in the relevant contract.

Where agreements do not provide for alternative rates to apply in the event of the cessation or material amendment of a reference benchmark, a material amendment to LIBOR or another reference benchmark may trigger provisions in the agreement designed to deal with unavailability of the relevant rate (for example, if references to LIBOR in the relevant agreement would be construed as references only to LIBOR in its current form and not as amended, meaning that "LIBOR" as defined in the agreement has ceased to be available). In some cases this may mean a risk that counterparties consider that fallback provisions in the contract are triggered that may not be appropriate for long-term use (e.g., reference bank rates or cost of funds). Some loan agreements (although not the case for LMA style agreements) may require the lender to notify the borrower of any change in rate, leading to potential disputes

over whether the contract is construed as referring to LIBOR as amended if the lender has not specifically notified the borrower of this change. In other cases the contract may not provide for a fallback at all, meaning that borrowers may seek to avoid performance on the basis of frustration or force majeure. In the context of LMA style agreements force majeure is less of a concern as the LMA templates do not include a force majeure clause that would be triggered in these circumstances, but this is likely to be a concern for other types of agreement.

While it is difficult to make general comments about the likelihood of success of these claims, the expectation is that if there is the potential for borrowers or counterparties to be in any way disadvantaged by changes to the methodology of LIBOR then this will result in claims being brought. Although in some cases these claims may be speculative, the cost to lenders and other counterparties of dealing with the claims and defending any consequent litigation, as well as the resulting disruption to the market, has the potential to be significant.

Question 3: Do you consider that a legal safe harbour is necessary in order to mitigate the impacts you have identified in response to the questions above?

Yes, we consider that a legal safe harbour is necessary to mitigate these potential impacts.

Question 4: Should any legal safe harbour contain the features highlighted by HM Treasury's stakeholder feedback? Please set out your reasoning, with reference to the Financial Services Bill provisions.

As mentioned above, we consider that it would be useful if the Financial Services Bill could clarify that, in the event that the FCA exercises its power to impose requirements on an administrator relating to the way in which a benchmark is determined, any changes in methodology would not have the following effects:

- Discharging or excusing performance under any contract (including, but not limited to, under any force majeure or other provision);
- Giving any person the right to unilaterally terminate or suspend performance under any contract;
- Giving rise to liability for a facility agent / calculation agent (or any person carrying on a similar role) where they use the amended rate in performance of their role under the contract;
- Constituting a breach of contract; or
- Voiding any contract.

We would also ask HMT to consider clarifying that any changes in methodology would not give rise to liability for any party where they decide to exercise any right, voting power or discretion available under the relevant agreement not to use synthetic LIBOR.

HMT may also wish to consider a provision stating that references to "LIBOR" (or the relevant designated benchmark) should be construed as references to LIBOR as calculated under the revised methodology. However, any such provision should be considered carefully to ensure that the benefit to legacy contracts with no fallback mechanisms is not outweighed by the potential detriment to counterparties with fallback or amendment mechanisms that are triggered upon material change to the methodology of a benchmark. This potential detriment could arise where the agreed fallback or amendment mechanism either is not triggered or where there is uncertainty around whether or not the fallback or amendment mechanism has been triggered (because references to LIBOR are construed as references to LIBOR as amended, so the fallback or amendment mechanism is never triggered). This may lead to counterparties being left with contracts that reference amended LIBOR when their agreed fallback, or rate agreed as part of an amendment mechanism, would have been another rate more suitable to their contract (e.g., bank rate), or may also lead to litigation where the position is simply uncertain. Under LMA style agreements, the parties may have included a replacement of screen rate clause which allows, upon the occurrence of certain triggers (including a material change of the benchmark), for changes to be made to a benchmark rate with a lower consent level than would otherwise be required (https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/risk-free-reference-rates-replacement-of-screen-rate-clause.pdf). The safe harbour should not cut across the ability of parties to move to an alternative rate if they agree to do so under the replacement of screen rate mechanism, as well as the parties' ordinary contractual rights under the relevant amendment provisions of the agreement(s). See also our response below to question 11.

It would also be useful if the Financial Services Bill could clarify that the exercise of this power would not mean that a contract has been amended, modified or novated (this clarification would be useful in the context of contracts referencing a designated benchmark, but would also be useful for the purposes of regulatory obligations that may otherwise be triggered by a material amendment of a contract).

Question 5: Are there any circumstances in which we should explicitly exclude the application of a legal safe harbour and if so, why?

[no response]

Question 6: Should a legal safe harbour only be required for contracts entered into before a benchmark is designated under Article 23A and therefore any contracts entered into after an Article 23A designation should not be in scope of safe harbour?

Although the application of a safe harbour regime may be easier where there is a set date, there are issues here to consider around the impact of a designation on in-flight negotiations.

If HMT does decide not to apply any legal safe harbour to contracts entered into after an Article 23A designation, it should ensure that market participants have sufficient time following receipt of notice of an Article 23A designation to reflect this in their negotiations. In particular, it will be critical for any legal safe harbour to offer protection in relation to the exercise by the FCA of its powers under Article 23D. If contracts executed after an Article 23A designation but before publication of notice of the details of a methodology change in accordance with Article 23D are excluded from the safe harbour, parties will be unable to reflect the amended methodology in their negotiations and will also be unable to rely on any safe harbour.

Whilst guidance from the regulators is that new transactions should stop utilising LIBOR as soon as possible, there is the potential that some contracts where it is not possible for alternative rates to be used will be in the process of being negotiated when the legal safe harbour comes into force. Such contracts may just miss the deadline and consequently not receive protection from any legal safe harbour provisions. We would ask HM Treasury to consider whether contracts which are executed during a set period after the enactment of any legal safe harbours, and where alternative rates cannot be used in such transaction, should also receive protection from legal safe harbours.

Question 7: Should any legal safe harbour apply to third parties such as facility agents, trustees or parties to contracts ancillary/ collateral to the main contract that reference or rely upon an Article 23A benchmark? If so, how?

Yes, we consider that any legal safe harbour should also apply to parties such as facility agents or calculation agents where they use the amended rate in performance of their role under the contract. These parties will not have the ability to choose not to use the amended rate and so are potentially at risk of incurring liability simply by continuing to perform their role under the contract in accordance with the amended terms. As a result, any legal safe harbour should offer protection to these parties.

In the absence of such protection, it is likely that trustees and agents will seek judicial interpretation of their role, potentially resulting in significant disruption to transactions.

We note that the safe harbour proposed under the New York Federal Reserve legislative proposal would include protection in relation to any person with rights or obligations "under or in respect of any contract, security or instrument". It will be important to align safe harbours across jurisdictions to the extent possible to avoid unintended consequences for multicurrency facilities.

Scope of any legal safe harbour

Question 8: Do you have any comments on the jurisdictional issues set out above, or on the proposed approach? In particular, can respondents provide any evidence of the volumes of LIBOR referencing contracts where the law of Scotland or Northern Ireland is the choice of law, that may benefit from safe harbour provisions?

We do not have any comments on the jurisdictional issues described in Chapter 3 of the Consultation and we would welcome a broad application of any safe harbour so that it would be available in relation to any English law governed contract affected by these proposals.

The LMA suite of template documentation does not include documents governed by the law of Scotland or Northern Ireland, and we are unable to comment on the volumes of LIBOR referencing contracts that may exist.

Question 9: Should the scope of any legal safe harbour go beyond supervised entities making "use" of an Article 23A benchmark in specified "financial contracts", "financial instruments", and "investment funds" as defined in the BMR?

Yes, we consider that the scope of any legal safe harbour should go beyond supervised entities making "use" of an Article 23A benchmark as defined in the BMR.

While the Financial Services Bill focusses on amendments to the UK Benchmarks Regulation, the proposed powers to require changes to the methodology of designated benchmarks will have an impact well beyond the contracts or instruments within the scope of the BMR.

Question 10: Should a legal safe harbour provide for situations where a contract describes the benchmark alongside, or instead of, the express name of the benchmark in question? If so, how? Please provide examples of contract wording to illustrate your response.

The LMA suite of template documentation refers to "LIBOR" by name, so this issue does not arise under LMA documentation. However, we are aware that other agreements may use different approaches and in principle we support application of a legal safe harbour in connection with any contract that is affected by the exercise of the FCA's powers under Articles 23A, B, C and D.

Question 11: How would we best ensure, within any legal safe harbour provisions, that parties to contracts falling in scope of the safe harbour retain the freedom to move away from referencing or relying upon a benchmark that has been designated as an Article

23A benchmark to alternative appropriate arrangements, or to terminate the contract, provided they reach consensual agreement?

In particular, how should safe harbour provisions interact with contractual fallbacks? Please provide examples of contractual wording where relevant.

As mentioned in our response to Question 4 above, any safe harbour provision should be considered carefully to ensure that the benefit to legacy contracts with no fallback mechanisms is not outweighed by the potential detriment to counterparties with fallback or amendment mechanisms that may be triggered upon material change to the methodology of a benchmark.

This potential detriment could arise where the agreed fallback or amendment mechanism either is not triggered or where there is uncertainty around whether or not the fallback or amendment mechanism has been triggered (because references to LIBOR are construed as references to LIBOR as amended, so the fallback or amendment mechanism is never triggered). This may lead to counterparties being left with contracts that reference amended LIBOR when their agreed fallback, or rate agreed as part of an amendment mechanism, would have been another rate more suitable to their contract (e.g., bank rate), or may also lead to litigation where the position is simply uncertain.

For example, under LMA style agreements, the parties may have included a replacement of screen rate clause which allows, upon the occurrence of certain triggers (including a material change of the benchmark), for changes to be made to a benchmark rate with a lower consent level than would otherwise be required (https://www.bankofengland.co.uk/-/media/boe/files/markets/benchmarks/risk-free-reference-rates-replacement-of-screen-rate-clause.pdf). The safe harbour should not cut across the ability of parties to move to an alternative rate if they agree to do so under the replacement of screen rate mechanism.

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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