

# **Statement of Policy on the exercise of the FCA's powers under Article 23D BMR**

March 2021

# 1 Introduction

## Summary

- 1.1 Our [Overview document](#) sets out the background to the Benchmarks Regulation ('BMR') and the amendments made by the Financial Services Act 2021 ('FS Act')<sup>1</sup> to give the FCA enhanced powers, in particular in relation to managing the orderly wind down of critical benchmarks which are no longer representative.
- 1.2 Article 23D of the BMR grants the FCA the ability, in certain circumstances, to impose certain requirements on the administrator of a critical benchmark designated under Article 23A.
- 1.3 We can designate a critical benchmark under Article 23A where we find that it is no longer representative of the market it is intended to measure, or its representativeness is at risk, and its representativeness will not be restored and maintained. Please see our [Statement of Policy](#) on designating benchmarks under Article 23A.
- 1.4 Following such a designation, the requirements we could impose on the benchmark administrator are set out in Article 23D(2). These relate to the way in which the benchmark is determined, the rules of the benchmark or, where the benchmark is based on submissions from contributors, the benchmark's code of conduct.
- 1.5 Article 23F(1)(d) of the BMR requires us to prepare and publish a Statement of Policy on how we use our powers under Article 23D. We must have regard to the Statement of Policy when exercising our powers and we are obliged to explain how we have taken account of it.
- 1.6 In November 2020, we published a [consultation](#) on our proposed policy approach in respect of applying Article 23D requirements to a benchmark that has been designated as an Article 23A benchmark.
- 1.7 This document sets out our final Statement of Policy in respect of Article 23D, fulfilling the requirement at Article 23F(1)(d). We have also published a [Feedback Statement](#) which summarises the feedback we received and our response.
- 1.8 We have sought to identify all relevant factors to a proposed decision to use our Article 23D powers. However, we will need to take any decision in light of the relevant circumstances and market conditions at the time, so we may consider that there is good reason to consider additional factors that are not listed in our Statement of Policy.
- 1.9 We may re-issue a revised version of the Statement of Policy in future if our policy changes.

## Relationship between the Statement of Policy and our prospective future decisions in respect of LIBOR

- 1.10 The legislative framework clearly anticipates that we prepare and publish a Statement of Policy before deciding to use our powers. In our view, it is an important fact that LIBOR

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<sup>1</sup> This document has been updated following the relevant BMR provisions under the FS Act being commenced on 1 July 2021.

is currently the only critical benchmark, and the only benchmark for which the Article 23D powers could presently be used. In that context and as anticipated by the consultation, this Statement of Policy has a particular focus on LIBOR.

- 1.11 We intend to consult in Q2 2021 about the prospective decisions on whether and how to use our Article 23D powers in respect of certain LIBOR currency-tenor settings. We will be seeking to give all users of LIBOR, including those outside the United Kingdom, an opportunity to engage with our consultation processes. We will welcome views from authorities and market participants in relevant overseas jurisdictions.
- 1.12 In due course, should other benchmarks become critical, we will revisit our Statement of Policy to ensure that they are adequately addressed, and to revise the Statements of Policy as necessary.

## Outcomes we are seeking

- 1.13 We will seek to use our Article 23D power in a way that is:
- (a) appropriate to secure the cessation of an Article 23A benchmark in an orderly fashion, and
  - (b) desirable to advance either or both of FCA's consumer protection objective and integrity objective.

## Who this affects

- 1.14 We expect that this Statement of Policy will be of interest to:
- administrators of critical benchmarks
  - contributors to critical benchmarks
  - regulated and unregulated users of critical benchmarks

## Next Steps

- 1.15 We will consult in Q2 2021 about prospective decisions on whether and how to use our Article 23D powers in respect of certain LIBOR currency-tenor settings. If we decide to impose requirements under Article 23D(2) on a benchmark administrator of a critical benchmark designated under Article 23A, we will publish a Notice in line with the requirements under Article 23D(7) of the BMR.

## 2 Statement of Policy - exercise of FCA's powers under Article 23D

### Context

- 2.1 Article 23D(3) provides that the FCA may only use Article 23D powers if:
- a. it considers it appropriate to do so having regard to the desirability of securing that the cessation of the benchmark takes place in an orderly fashion, and
  - b. it considers it desirable to do so in order to advance either or both of its consumer protection objective and its integrity objective

### Statement of Policy

#### Decision on whether to use the powers

- 2.2 When deciding whether to use our powers under Article 23D, we must take into account each criterion set out in Article 23D(3).

#### Appropriateness of using the powers having regard to the desirability of securing an orderly cessation of a critical benchmark

- 2.3 First, we will consider whether 'tough legacy' contracts referencing the critical benchmark will exist at the cessation date(s) proposed by the benchmark administrator. These are contracts and/or instruments that do not contain fallbacks, or contain inappropriate fallbacks and cannot practicably be transitioned away from the benchmark rate by actions or agreements by or between the contract counterparties themselves within the likely timescales for the cessation of the benchmark.
- 2.4 To identify whether there are tough legacy contracts, we will assess information on the amount of outstanding legacy contracts that reference the benchmark as a whole or some specific versions of the benchmark. We will also look at:
- the duration and nature (including the complexity) of the contracts
  - the sophistication of parties to these contracts and, therefore, their ability to understand the consequences of transition, and likely ability to undertake transition within the necessary time frame
  - the practicability and likelihood of amending these contracts in a fair way by mutual agreement or other contractual mechanism without our intervention
  - other relevant information which could evidence the effect in relevant jurisdictions of any intervention
- 2.5 We will look at public and non-public data. In particular, we will:
- take into account the views of working groups established in affected jurisdictions with the express intent of addressing transition and cessation issues, as well as other affected market participants and stakeholders (including users of the benchmark).

- take into account views from authorities responsible for financial stability, market integrity and consumer protection issues in the jurisdictions in which there is significant use of the benchmark.
- where needed, elicit further views by a process of consultation as part of our decision-making. This could happen, for example, when we have contradictory information or data are not sufficient.

2.6 Once we establish the existence of tough legacy contracts based on the factors above, we will then consider whether it would be desirable for us to use the powers to advance one or both of our statutory objectives as set out below.

Desirability of using the powers to advance our consumer protection and/or integrity objectives

2.7 In addition to considering whether it is appropriate to use our powers to secure an orderly cessation of the benchmark, we will also need to meet the other condition set out in Article 23D(3). That is, that the use of our power is desirable to advance our objectives of securing an appropriate degree of protection for consumers and / or protecting and enhancing the integrity of the UK financial system.

2.8 To establish this, we will consider whether the cessation of the benchmark at the date(s) proposed by the administrator would pose a material risk to consumers and / or the integrity of the UK financial system, taking into account the existence and scale of tough legacy contracts.

2.9 When considering consumer protection, we will consider whether and how consumers are affected, with regard in particular to:

- their level of exposure to the critical benchmark in terms of the number, materiality and duration of consumer contracts referencing the benchmark
- the likely and possible financial effect on consumers, especially any expected change in the cost or risk borne by consumers
- the likelihood that consumers would achieve fair outcomes should we intervene or not; and the ability of consumers to manage as necessary the consequences should we intervene, or not.

2.10 When considering market integrity, we will, in particular, consider the impact of any intervention in terms of:

- orderliness: including whether market transactions can continue more or less as expected, the risk of market disruption, litigation and disputes, and client preparedness
- resilience: the ability of firms and market infrastructure to continue functioning, serve their customers, and meet obligations to counterparties
- transparency: including sufficient clarity about the rights and obligations defined in contracts and how they will be determined in future
- cleanliness: including the impact on the likelihood of market abuse or fraud

2.11 Where a benchmark is used outside the UK, we will have regard to the situation outside the UK, and particularly to the impact of a disorderly wind-down outside the UK, when considering the Article 23D(3) criteria.

2.12 Further, we will consider the feasibility of producing the benchmark through a changed methodology, as further set out in 'how we would use the powers'. It is unlikely that we would use our powers, even if it might be desirable to do so, if the necessary and appropriate inputs are unavailable for the benchmark administrator to produce the benchmark through a changed methodology.

### Decision on how we would use the powers

2.13 Once we consider that the legislative conditions set out in Article 23D(3) are met to use our powers, we will consider the below key factors in deciding how to use our powers. Throughout our decision-making process, we will continue to consider those legislative conditions in Article 23D(3) which inform and govern our use of the powers.

#### Fair approximation of the value the benchmark would have had

2.14 We will seek to achieve a reasonable and fair approximation of the benchmark's expected value. We will have regard to the underlying market or economic reality that the benchmark intended to measure before it was designated as an Article 23A benchmark. As it will not be feasible to replicate precisely the previous approach to continue to publish it on a representative basis, we will look for other ways of approximating the value. For example, based on historical observations of factors that can no longer be robustly approximated on a dynamic basis.

#### Least disturbance or disadvantage to affected parties

2.15 We will seek to use the powers in a way which causes the least disturbance or disadvantage to affected parties. For example, we will take into account how best to:

- Maintain the ability to value and hedge affected contacts
- Align with the approach taken by those who are transitioning away from the benchmark
- Make sure that any change resulting from the use of and any subsequent re-exercise of our powers is clear and transparent. This includes how best to keep the market informed in a timely and transparent manner
- Minimise disruption, for example by considering whether the modified approach could be extended voluntarily by market participants following the end of the modified benchmark. This may be possible if the component parts are visible and available to market participants.

#### Market support

2.16 We will take into account whether market support has already been established, through public or private sector-led working groups, and/or open consultation, on a fair way of calculating a replacement value for the benchmark that has been designated as an Article 23A benchmark.

#### Availability to the benchmark administrator of robust and transparent inputs

2.17 Where we are able to establish that the necessary inputs to produce the benchmark under a changed methodology do exist, we will consider and assess the input based on the factors below.

- 2.18 Any methodology change would need to produce a rate robust enough to support an orderly wind down. We will consider the quality, reliability and transparency of the necessary inputs to produce a robust benchmark under a changed methodology. We will also consider the benchmark's vulnerability to manipulation based on the proposed, changed methodology.
- 2.19 Article 23D(2)(a) allows us to direct the administrator as to the input data that should be used in any changed methodology. We will consider exercising our discretion in determining the input data, for example where we consider it inappropriate to grant the administrator discretion (if, for instance, this resulted in conflicts of interest that could not be adequately mitigated, or we considered that this would entail unreasonable legal risks to the administrator).
- 2.20 In other circumstances, we might judge that the administrator would be better placed to choose or to calculate some elements of the input data that would deliver an outcome that we considered to be desirable to protect consumers and/or enhance integrity. Or we might conclude that there was only a single set of input data that would achieve the outcome we were seeking, so there was no opportunity to use discretion.
- 2.21 In some cases, there may be only a single provider of one or more of the inputs which we would want to use as part of a changed methodology. Where there are multiple potential providers of input data, we will identify and assess them relative to each other on an objective, fair, reasonable, non-discriminatory, proportionate and transparent basis. We will have particular regard to the robustness and transparency of the inputs when assessing the providers and, where appropriate, whether they are subject to the IOSCO principles for financial benchmarks, the BMR or equivalent requirements. We will also have regard to whether the inputs are available to the administrator on acceptable terms (see paragraphs 2.22-2.23).

#### Impact on the benchmark administrator

- 2.22 We will take account of the impact that a change in the methodology may have on the benchmark administrator. In particular, whether the administrator is operationally able to produce the benchmark under the changed methodology, as well as the financial or commercial impact this would have on the benchmark administrator.
- 2.23 Use of an Article 23A benchmark by supervised entities in the UK will be restricted and therefore the benchmark will be of limited remaining commercial value to its administrator. In these circumstances, if the inputs necessary to make that change were only available to the administrator on terms that would clearly cause the administrator to suffer a material financial loss that could not reasonably be recouped, or a liability to the supplier of those inputs that we considered commercially unreasonable, we may decide not to use our powers to require use of those inputs. Alternatively, we would explore the ability of the administrator to produce similar inputs from its own resources or consider whether there is any appropriate, alternative methodology.

#### Length of publication on a changed basis

- 2.24 Article 23E requires us to review every 2 years whether the use of our Article 23D powers has advanced our objectives of consumer protection and integrity<sup>2</sup>. A changed methodology could apply for the entire period of publication until the benchmark's cessation, subject to this review.

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<sup>2</sup> We will be able, under Article 21 of the BMR, to require the benchmark administrator to continue publication of the benchmark for up to 10 years, subject to our annual review on whether continuing this requirement remains necessary.

2.25 Our policy intention is to intervene for as short a time as is appropriate to assure an orderly wind down of the critical benchmark in line with our statutory objectives.

Likely effect outside the United Kingdom of exercising the power

2.26 We will take into account the likely effect of the use of the Article 23D power, where the benchmark is used outside the United Kingdom. We will do so by extending our engagement and any consultation processes to market participants outside the United Kingdom. We continue to welcome views from authorities and market participants in relevant overseas jurisdictions.