Feedback Statement: 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 proposed by the Government under the Financial Services Bill 2020 ('FS Bill') to give the FCA enhanced powers, in particular in relation to managing the orderly wind down of critical benchmarks which are no longer representative. These powers have been introduced to allow the FCA to address effectively the issues relating to LIBOR transition.

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 exercise our powers under Article 23D. We must have regard to this Statement when exercising our powers, and we are obliged to explain how we have taken account of the relevant Statement of Policy.

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. In our view, it is an important fact that LIBOR is currently the only critical benchmark, and the only benchmark in respect of which the Article 23D powers could presently be exercised. In that context, our consultation had a particular focus on LIBOR.

1.7 This document summarises the feedback we received and our response. We have also published our Statement of Policy for Article 23D, fulfilling the requirement at Article 23F(1)(d).

Who this affects

1.8 We expect that this Feedback Statement and the Statement of Policy will be of interest to:

- administrators of critical benchmarks
- contributors to critical benchmarks
- regulated and unregulated users of critical benchmarks

Summary of the feedback we received

1.9 We received 42 responses from banks, asset managers, trade bodies, benchmark administrators, an insurance company, a national benchmark working group, a law firm and a government entity, with respondents originating from the UK and abroad.

1.10 Most respondents agreed with our proposals. Some respondents suggested we should consider further details and clarifications to the proposed factors.

What we are changing from our proposal

1.11 We consulted on the factors that we proposed to take into account when determining whether to use Article 23D powers over an Article 23A benchmark, and how to use our powers. Article 23D(3) provides that the FCA may only exercise the 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 to advance either or both of its consumer protection objective and its integrity objective

1.12 In determining whether the above legislative conditions are met, we proposed that we would consider:

- the existence and scale of 'tough legacy' contracts referencing the benchmark and the practicability of transition
- the risk of a disorderly cessation and whether an orderly cessation could be achieved without our intervention
- the feasibility of producing the benchmark through a changed methodology
- a non-exhaustive list of factors in determining whether our exercise of the powers would be desirable to advance our consumer protection objective and/or integrity objective

We would have regard to the situation outside as well as within the UK.

1.13 In determining how to exercise our powers, we proposed to consider the following factors:

- fair approximation of the value the benchmark would have had
- the least disturbance or disadvantage to affected parties
- market support on a fair way of establishing the replacement value
- availability to the benchmark administrator of robust and transparent inputs
- impact on the benchmark administrator
- length of publication on the basis of a changed methodology
- the likely effect both within and outside the United Kingdom of exercising the power

1.14 We are confirming in our Statement of Policy that we will include consideration of the factors that we outlined in our consultation on the exercise of FCA's powers under Article 23D. In addition, after reviewing the responses, we have expanded some of the considerations that underpin the factors that we proposed. This is in relation to 4 issues as below.

- We will assess information on the complexity of contracts and sophistication of parties to these contracts, both of which would impact parties' ability to understand and effect transition within the necessary timeframe when we assess the existence and scale of tough legacy contracts.

- We will take into account the views of users of the critical benchmark, in addition to the views of working groups established in affected jurisdictions, views from authorities, other affected market participants and stakeholders.
- We will consider how best to keep the market informed in a timely and transparent manner, in order to ensure that any change resulting from the use of our powers is clear and transparent.
- We will consider the risk of market disruption, litigation and disputes, as well as client preparedness, when we consider the impact of any intervention on the orderly functioning of the market as part of our integrity objective.

Equality and diversity considerations

1.15 We do not consider that our Statement of Policy will adversely affect consumers with protected characteristics under the Equality Act 2010.

Compatibility considerations

1.16 Where the FCA is determining the general policy and principles by reference to which it performs particular functions we have to comply with certain requirements under section 1B of the Financial Services and Markets Act 2000 ('FSMA'). We confirm that this Statement of Policy is compatible with our strategic objective and it advances our consumer protection and integrity objectives.

1.17 We have complied with our competition duty when developing the Statement of Policy for Article 23D, so as to ensure that it promotes effective competition in the interests of consumers insofar as that is compatible with advancing our consumer protection objective and integrity objective. For more information see paragraph 2.79 of this Feedback Statement. We have also, where relevant, had regard to the section 3B FSMA regulatory principles, the need to take action to minimise financial crime and the Treasury's recommendations to the FCA about aspects of the government's economic policy.

Next Steps

1.18 We have published our Statement of Policy, as required under Article 23F(1)(d) of the BMR. We will have regard to the Statement of Policy when exercising the Article 23D powers.

1.19 We will conduct a further consultation in Q2 2021 about our prospective decisions on whether and how to use the 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. We will welcome views from authorities and market participants in relevant overseas jurisdictions.

2 Key Issues and our Response

General

2.1 We said in our consultation that we would consult further about specific future decisions to exercise the Article 23D power. We said that, in particular, we would be seeking to give all those who are parties to 'tough legacy' contracts or instruments, including those outside the United Kingdom, an opportunity to engage. We asked consultees:

Q1: Do you have any view on how best to consult in respect of our prospective decisions to exercise our Article 23D(2) power in respect of LIBOR?

2.2 Seventeen respondents noted that international engagement is important when consulting on the Article 23D(2) decision. Some respondents asked that we consult broadly and try to seek input from a wide range of stakeholders. Others asked that we engage with international stakeholders ahead of our consultation.

2.3 Eleven respondents pointed to the importance of timely action. They called on us to conduct our consultation to a timeframe that allowed the market time to prepare operationally. One respondent asked for a consultation response period that was longer than the consultation period on the proposed Article 23D Statement of Policy. Seven respondents also requested a timely FCA response and implementation of policy decisions.

2.4 Ten respondents suggested engaging a diverse range of counterparties. Notably, we should seek to engage with unregulated and corporate end-users, non-financial firms and technology companies who would support development work needed for a synthetic rate.

2.5 Five respondents requested additional FCA engagement alongside the consultation. Suggestions included webinars, workshops, Q&A sessions and other ad-hoc engagement.

2.6 Three respondents asked for the consultation to provide clarity on how our Article 23D powers will be used and one respondent asked that we consult on decisions not to exercise the Article 23D powers.

2.7 Other feedback included suggestions related to the structure and distribution of the consultation, best practices from other consultations and pre-engagement with industry bodies.

Our response:

<u>Breadth of Consultation</u>

2.8 As noted in our consultation, we will be seeking input from a wide range of market participants, including those outside the United Kingdom. We regularly engage with participants in the risk-free rate (RFR) working groups and regulatory authorities internationally including in the US, EU, Switzerland and Japan. We will continue to do so and incorporate feedback from them into our policy and decision-making considerations.

2.9 We agree that the consultation should reach as broad an audience as possible. We received responses to this consultation from a diverse range of firms, both geographically and from among financial services organisations and trade associations. We would welcome and encourage industry participants and trade associations to circulate our future consultations broadly among their clients, counterparties and members. We will also seek to do so through international regulatory channels.

Timing of our consultation on Article 23D decisions

2.10 We are aware of the need for firms to have as much information as possible and as soon as practicable to aid their preparations. We intend to consult in a manner which will balance making informed, robust decisions with keeping the market informed in a timely manner.

2.11 We will consult on specific future decisions to exercise the Article 23D power for certain LIBOR currency-tenor settings in Q2 2021.

Decision on whether to use the powers

2.12 As outlined in our consultation, Article 23D(3) provides that the FCA may only exercise the 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 to advance either or both of its consumer protection objective and its integrity objective

2.13 To support our consideration of the first legislative condition (a) which governs the exercise of our powers, we proposed that we would assess the risk of cessation occurring in a disorderly fashion based on the below factors:

- The existence and scale of 'tough legacy' contracts referencing the benchmark and the practicability of transition by the cessation date(s) proposed by the administrator. We proposed to look at public and non-public data which could help to identify the amount of outstanding legacy contracts and their duration, the nature of the contracts and the practicability of amending them in a fair way by mutual agreement or other contractual mechanism, and other relevant information which could evidence the effect in relevant jurisdictions of any intervention. On this, we asked consultees whether they agreed with this proposal **(Q2).**

- Regarding the 'scale', we proposed that the level of 'tough legacy' contracts must be significant to justify our intervention. We proposed that in assessing the significance of the problem we would consider the amount of use in tough legacy contracts of the benchmark or specific currency-tenor settings of the benchmark, the duration of the contracts linked to the relevant setting and the likelihood that parties to contracts referencing the benchmark would achieve a fair outcome in the absence of our intervention. The rationale was that we must be satisfied that the cessation of the benchmark would pose a material risk to consumer protection and integrity, and that our intervention would be desirable to advance consumer protection and integrity objectives. This proposed factor is linked to our consideration of the other legislative condition as set out in paragraphs 2.14-2.15 below. We asked consultees whether they agreed with this proposal **(Q3).**

- The feasibility of producing the benchmark through a changed methodology. We proposed that we would not use the powers where appropriate inputs, necessary for the benchmark administrator to produce the benchmark through a changed methodology, are not available. This point was further considered in determining how we would use our powers.

- We also proposed to consider whether orderly cessation is possible if we did not exercise Article 23D powers. We proposed that one of the factors we might take into account in reaching this conclusion is the likely timescales for 'cessation' of the benchmark. Another is the circumstances which have given rise to the unrepresentativeness of the benchmark and how that affects parties to different types of contract. We asked consultees views on this **(Q4).**

2.14 Under the legislative regime, it is not enough for us to consider that intervention is appropriate having regard to the desirability of securing cessation in an orderly fashion. We must also be satisfied that the intervention is desirable to meet one or both of our consumer protection objective and integrity objective.

2.15 To support our consideration of the second legislative condition (b), we proposed that we would consider whether it is desirable to use our powers to advance either or both of our consumer protection objective and integrity objective, based on the below factors:

- Regarding consumer protection, we proposed to consider whether and how consumers are affected, with particular regard 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 understand and manage as necessary the consequences should we intervene, or not

- Regarding integrity, we proposed to consider, in particular, the impact of any intervention in terms of:
  - orderliness: including whether market transactions can continue more or less as expected
  - 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

2.16 Where a benchmark is used outside the UK, we proposed to 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) legislative conditions.

2.17 Based on the above proposals, we asked consultees if they have any further views on how we intend to consider whether our intervention by using Article 23(D) powers is desirable **(Q5)**.

Q2: How should we evaluate the practicality of transition and the scale of 'tough legacy'?

2.18 Fourteen respondents agreed with the approach we proposed in our consultation. No respondent disagreed with our proposed approach. However, twenty respondents raised additional considerations which are described below. Four respondents had no comments.

2.19 Sixteen respondents asked for a clear definition of 'tough legacy'. Six respondents highlighted the complexities of contracts and the challenges and costs associated with reaching out to potentially multiple counterparties with varying degrees of sophistication, especially within the current transitional timeframe. They also noted that it is important to take into account views from users of LIBOR. Four respondents voiced concerns around international divergence on identifying tough legacy.

2.20 Two respondents were of the view that it is not possible currently to determine the full scale of 'tough legacy' contracts as the impracticality of LIBOR transition will only fully be known when transition is attempted.

2.21 One respondent commented that for potential tough legacy contracts referencing Japanese yen LIBOR, it may take some additional time after end-2021 for those contracts to transition away.

Our response:

2.22 Many respondents agreed with the factors we proposed in establishing the existence and scale of tough legacy as well as the practicality of transition, so we have retained those factors in our Statement of Policy.

2.23 We agree with respondents that the complexity of contracts and sophistication of parties to these contracts are also important factors in assessing the risk of a disorderly cessation of a critical benchmark. Our proposed factors, ie 'the nature of contracts' and the 'practicability of transition' were meant to cover these considerations. To further clarify and assure, we have explicitly included 'the complexity of contracts', 'sophistication of parties' and their ability to understand and effect transition within the necessary timeframe in our Statement of Policy.

2.24 We agree that views from users of the benchmark are important in informing our decisions on whether to exercise the powers. As such, we have included this factor in our Statement of Policy.

2.25 We agree with respondents on the importance of taking international aspects into account. When considering whether to exercise our powers over a benchmark used outside the UK, we will, as proposed, have regard to the situation outside of the UK including the impact of our powers on the users of the benchmark outside the UK. We have retained this factor as proposed in our Statement of Policy.

2.26 We are not at present defining 'tough legacy' contracts. We will consult on our Statement of Policy for the Article 21A and 23C powers in Q2 2021.

2.27 For LIBOR, the market should continue its effort to transition. We expect market participants to cease issuing any new LIBOR referencing contracts in line with milestones published by the Sterling Risk Free Rate Working Group and its equivalents in other jurisdictions. We also expect contracts to contain appropriate fallbacks in line with BMR requirements.

Q3: Do you agree that the scale of 'tough legacy' must be significant in order to justify intervention?

2.28 Most respondents, 22, disagreed at least to some extent that the scale of 'tough legacy' must be significant to justify intervention. Thirteen respondents agreed at least to some extent that the scale must be significant, of which nine expressed some reservations. Three respondents neither agreed nor disagreed but did comment on our proposal.

2.29 Among those who disagreed, thirteen respondents suggested that the objectives of consumer protection and integrity should take precedence and that this could mean that we should exercise Article 23D irrespective of whether the scale of 'tough legacy' is significant.

2.30 Among those respondents who disagreed and those who agreed, eight respondents suggested that the definition of 'significant' should be clarified. Three respondents suggested that it should take into account the prevalence of different counterparties, contract types and complexities rather than rely on just absolute amounts.

2.31 Two respondents asked for transparency around the data sets we use to inform our decisions.

Our response:

2.32 We note that most respondents disagreed that the scale of 'tough legacy' must be significant to justify our intervention. We also note respondents' suggestion that we should intervene based on our objectives of consumer protection and integrity, irrespective of the scale of 'tough legacy' contracts.

2.33 The Article 23D powers make clear that the legislative conditions in which we are able to act are: (a) if we consider 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) if we consider it desirable to do so in order to advance either or both of our consumer protection objective and/or our integrity objective.

2.34 Once we establish the existence of 'tough legacy' contracts at the cessation date(s) proposed by the administrator, we will need to assess the extent of these contracts. We do not propose prescriptively to define or set a threshold for the significance of 'tough legacy' issues. Our assessment will be based on whether it poses a risk to an orderly cessation of a critical benchmark, and whether it causes harm to consumer protection and integrity. We think it unlikely that there would be a threat to market integrity unless the scale of use was significant. Conversely, if there was a threat to market integrity, this is likely to be a strong indication that the threshold of significance has been reached.

2.35 Our overall aim is to ensure an orderly cessation of a critical benchmark and to make sure the use of our powers advances either or both of the consumer protection objective and integrity objective. Where users of the benchmark are able to make necessary transition arrangements or renegotiate existing contracts by way of mutual agreement themselves within the likely timescales of the cessation date(s) of the benchmark, it would not necessarily pose a risk to the orderly wind-down of the Article 23A benchmark.

2.36 In some circumstances, requiring publication of a benchmark under a changed methodology might help a small proportion of contract holders, including consumers, but cause harm to other consumers and/or the integrity of the market, including when applied to other contracts for which we were unable to limit use of the amended benchmark. In this case, we would likely consider that the legislative conditions set out in Article 23D(3) which govern the exercise of our powers are not met and we would not exercise our powers.

2.37 It is possible that only a very small number of consumers would be protected by use of our powers. In this case, we would want to balance the benefits of our intervention with the costs, including for the benchmark administrator, to ensure an intervention requiring the administrator to continue publication under a changed methodology would be proportionate. It is considerations such as these that motivated our proposal that tough legacy use would need to be significant to justify use of our powers. However, where there is a material consumer protection or integrity issue that is significant enough to outweigh others' costs and the potential downsides of intervention, we would consider using our powers.

2.38 It is the above considerations that will govern and inform our decision on whether the two legislative conditions for exercising the Article 23D powers are met. As such, our Statement of Policy does not specifically refer to or define 'significance' of the scale of 'tough legacy' contracts.

2.39 Further, as we also proposed in determining how to exercise our powers, we need to consider whether it is feasible to act. For example, if there was no alternative input data upon which to base a change in methodology, it would not be feasible to exercise Article 23D powers.

2.40 We are not at present defining 'tough legacy' contracts. We will consult on our Statement of Policy for Article 21A and 23C powers in Q2 2021.

Q4: Under what circumstances might orderly transition be achieved without the use of Article 23D powers?

2.41 We received no responses that suggested a market-led solution could achieve an orderly transition without some form of intervention within the time frames of LIBOR's expected cessation dates.

2.42 Nine respondents suggested that the only circumstances in which one could foresee an orderly transition of LIBOR within the current timeframes without the use of our Article 23D powers would be the use of another legislative solution in the UK.

Our response:

2.43 We have retained this factor as proposed in our Statement of Policy.

2.44 We note the feedback that given the timeframes of expected cessation of the rate, and the fact that there is unlikely to be another legislative solution in the UK in the time permissible, there is a case for the exercise of Article 23D powers for certain LIBOR currency-tenor settings, where both of the legislative conditions set out in Article 23(D) are met. This feedback is part of our rationale for announcing alongside Article 23D Statement of Policy our intention to consult on our prospective decisions to use the powers for some LIBOR settings.

Q5: Do you have any views on how we intend to consider whether intervention is desirable?

2.45 Seven respondents emphasised the importance of international coordination in considering any intervention. One respondent suggested that relevant jurisdictions' official bodies should endorse where Article 23D power is exercised by us, for example, Japanese authorities' endorsement for Japanese yen synthetic LIBOR.

2.46 In addition, one respondent said we should consider whether borrowing costs would increase when considering consumer protection.

2.47 Regarding our proposed 'orderliness' criterion when considering our integrity objective, five respondents thought it should also include the risk of market disruption, litigation and disputes as well as client preparedness. Two respondents suggested market transactions should consider both regulated and unregulated activities.

2.48 Two respondents said that we should not exercise our Article 23D powers before end-2021 other than to define tough legacy. However, another respondent said that intervention is desirable as early as possible.

Our response:

2.49 We agree with respondents on the importance of coordinating internationally with an aim to ensure consistent outcomes for the market and users. We have retained the 'international impact' factor as proposed in our Statement of Policy.

2.50 We expect any consideration of costs to consumers to fall within our proposed factors under consumer protection. We have retained this factor as proposed in our Statement of Policy.

2.51 We agree that our proposed 'orderliness' criterion should also cover the suggested elements of the risk of market disruption, litigation, disputes and client preparedness. We have included these elements as part of the 'orderliness' criterion in our Statement of Policy. Further, any changes to an Article 23A benchmark's methodology should flow into existing contracts, including regulated or unregulated, that reference the benchmark.

2.52 We note respondents' comments regarding the timing of our exercise of the Article 23D power. For LIBOR, which is currently the only critical benchmark that Article 23D power may apply to, we do not intend any exercise of our Article 23D powers to become effective before end-2021. This is because we do not expect LIBOR to cease or become non-representative before end-2021.

How we would use the powers

2.53 We proposed the following elements to consider how we would use the Article 23D powers to impose requirements on the administrator of a critical benchmark designated under Article 23A:

- fair approximation of the value the benchmark would have had
- least disturbance or disadvantage to affected parties
- market support on a fair way of establishing the replacement value
- availability to the benchmark administrator of robust and transparent inputs
- impact on the benchmark administrator
- length of publication on a changed basis
- likely effect outside (as well as inside) the United Kingdom of exercising the power

2.54 We asked market participants:

Q6: Do you think we have identified all the relevant factors?

Q7: Are there any further issues which we need to consider in our approach to using our powers?

2.55 Most respondents, 23, thought we had identified all relevant factors. Fifteen respondents suggested additional considerations underpinning the factors that we originally proposed.

<u>Fair approximation of the value the benchmark would have had</u>

2.56 All respondents agreed that this is an important consideration.

2.57 Five respondents suggested alternative approaches specifically for a 'fair approximation' of LIBOR. We cover those suggestions and our response in paragraphs 3.1-3.9.

Least disturbance or disadvantage to affected parties

2.58 We proposed a non-exhaustive list of factors we would consider when we exercise our power in order to cause the least disturbance or disadvantage to affected parties.

2.59 Thirteen respondents highlighted the importance of clear FCA communication to give the market sufficient time to react and prepare where we intend to exercise our powers. Among these, five respondents asked us to communicate our decision to use our powers sufficiently in advance of the actual exercise of our power. Two respondents asked for advanced notice between our decision to stop using our Article 23D powers and the actual end of the publication of a critical benchmark under a changed methodology. Two respondents called for parallel, coherent communications from us and the benchmark administrator.

2.60 Five respondents were concerned about the implication of our use of the Article 23D powers for contracts that contain cessation fallbacks only. Where the cessation fallbacks are not triggered in case of the continued publication of a critical benchmark under a changed methodology, respondents were concerned that those contracts may fall back on a synthetic rate which is undesirable.

2.61 One respondent suggested that where there is substantial methodology change to a critical benchmark (eg LIBOR), this represents cessation of the current benchmark and the establishment of a new replacement rate.

Market support on a fair way of establishing the replacement value

2.62 No respondent provided further views on this.

Availability to the benchmark administrator of robust and transparent inputs

2.63 We proposed to consider quality, reliability and transparency of the necessary input data to produce a robust benchmark under a changed methodology. We also proposed to consider the benchmark's vulnerability to manipulation.

2.64 A small number of respondents commented on the potential for self-preference where the administrator produces a potential input that is necessary for a changed methodology, and the desirability of the administrator having the discretion to choose inputs where it is required to publish a benchmark under a changed methodology.

Impact on the benchmark administrator

2.65 In addition to the availability of robust and transparent input data to the administrator, we proposed that we would consider the financial or commercial impact on the benchmark administrator when considering how to use our powers to require a changed methodology.

2.66 A small number of participants commented on whether acceptable terms should be a consideration. There was some support for this, however issues were also raised about whether this factor could lead to input selection bias and a suboptimal changed methodology.

Length of publication on the basis of a changed methodology

2.67 Two respondents asked us to clarify for how long a critical benchmark could be published under a changed methodology in order to wind it down.

Likely effect outside the United Kingdom of exercising the power

2.68 All respondents agreed that this is an important factor to consider.

2.69 Fourteen respondents highlighted the importance of having a coordinated approach internationally, and importantly between UK, EU and US given their respective legislative proposals. One respondent called for UK intervention to have extra-territorial effect and be valid in other jurisdictions.

Our response

Fair approximation of the value the benchmark would have had

2.70 We have retained the factor we outlined in our consultation.

Least disturbance or disadvantage to affected parties

2.71 We proposed that we would consider how best to make sure that any change resulting from the use of our powers is clear and transparent. We agree on the value of firms having relevant information as soon as practicable to aid their preparations where we intend to use our powers. We agree with respondents that clear and transparent communication is important in achieving this. As such, we have expanded and clarified the relevant factor in our Statement of Policy.

2.72 We note the concerns around the inoperability of cessation fallbacks in contracts. As proposed, we would consider a non-exhaustive list of factors in determining how to use our powers in a way which causes the least disturbance or disadvantage to affected parties. For example, we proposed to take into account how best to align with the approach taken by parties who are transitioning away from the benchmark. For LIBOR, this means we would consider the implications of exercising Article 23D powers for contracts with existing fallback arrangements in the event of LIBOR ceasing or becoming unrepresentative. In the meantime, we encourage market participants to reach agreement where feasible to transition away from LIBOR. This is the only way for parties to have certainty and control over their contractual terms when LIBOR ceases or is no longer representative. Our intention by imposing a 'synthetic' LIBOR would be to help those legacy contracts which genuinely cannot transition away and might be frustrated in the event of LIBOR cessation.

2.73 Regarding the comment that a substantial methodology change represents cessation of the current benchmark and the establishment of a new replacement rate, our view is that this is not consistent with the legislation. Our powers, including those under Article 23D, would be granted to us by Parliament to help manage an orderly wind-down of a critical benchmark before it finally ceases. As such, where a critical benchmark continues to be provided by the administrator under a changed methodology, the benchmark continues and it is not deemed as a new replacement benchmark. In the context of LIBOR, this means that 'synthetic' LIBOR remains LIBOR and it should flow into existing contracts that reference LIBOR to minimise market disruption.

2.74 We have retained this factor as proposed in our Statement of Policy with the clarification described in paragraph 2.71.

Market support on a fair way of establishing the replacement value

2.75 We have retained the factor as proposed in our Statement of Policy.

Availability to the benchmark administrator of robust and transparent inputs

2.76 Our view is that any methodology change would need to produce a rate robust enough to support an orderly wind down. In considering the necessary input data to produce a robust benchmark under a changed methodology, we proposed to consider quality, reliability and transparency of the necessary inputs. We would also consider the benchmark's vulnerability to manipulation. We will consider, where appropriate, whether providers of input data are subject to the IOSCO principles for financial benchmarks, the BMR or equivalent requirements.

2.77 As to the role of the benchmark administrator in selecting any necessary input data, our powers under Article 23D would allow us to direct the administrator as to the input data that should be used in any changed methodology to produce a robust rate. We will consider exercising our discretion in determining the input data, 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).

2.78 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 market 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 exercise discretion.

2.79 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, with a particular regard to the robustness and transparency of the inputs. This is in line with our duty under Section 1B(4) of FSMA as set out in paragraph 1.17.

2.80 We have retained this factor as proposed in our Statement of Policy.

<u>Impact on the benchmark administrator</u>

2.81 Our consultation outlined why we considered that the inputs necessary to make that methodology change should be available to the administrator on commercially reasonable terms, otherwise it is unlikely that we would be minded to use our powers to require use of those inputs. Alternatively, we proposed that we could explore the capability of the administrator to produce similar inputs from its own resources or consider an alternative methodology. In any case, and as we noted in paragraph 2.76, we will consider the quality, reliability and transparency of the necessary inputs.

2.82 We think that ensuring the necessary, robust and transparent inputs, provided either by other providers or the administrator itself, are available to the administrator on commercially reasonable terms is important to produce a robust benchmark under a changed methodology and to avoid extra costs being passed on to and born by consumers. It is consistent with our statutory objectives of consumer protection and integrity.

2.83 Applying these policy considerations to LIBOR, we will be assessing potential term rate providers in due course with a view to proposing one of them as the provider of a component input for the synthetic sterling LIBOR.

2.84 We have retained the factor as proposed in our Statement of Policy.

<u>Length of publication on the basis of a changed methodology</u>

2.85 Under Article 21 of the BMR, we would be empowered to require an administrator to continue publication of the benchmark for up to 10 years, but would have to re-assess each year whether continuing this requirement remains necessary.

2.86 Separately, any use of the power to require a change to the benchmark's methodology, rules or code of conduct is also subject to a 2-yearly review of whether the intervention has advanced our consumer protection or integrity objectives. A changed methodology could apply for the entire period of publication until the benchmark's cessation, subject to this review.

2.87 Our proposed policy intention was 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.

2.88 We have retained this factor as proposed in our Statement of Policy.

Likely effect outside the United Kingdom of exercising the power

2.89 We agree with respondents on the importance of global coordination and consistency in considering how to use our powers. Any methodology change we impose on the benchmark administrator should flow through to all existing contracts that reference the benchmark and do not have arrangements to transition to alternative rates upon such methodology change. For a benchmark used outside the UK, we will take into account the likely effect outside the UK of the use of the Article 23D power. We will continue to engage closely with other jurisdictions bilaterally and through international bodies, including FSB and IOSCO.

2.90 We have retained this factor as proposed in our Statement of Policy

Comments outside the scope of Article 23D Statement of Policy

2.91 We also received responses that were not relevant to our policy approach to the use of Article 23D powers. These relate to our future decision on exercising Article 23D power and our upcoming consultations on other new powers under BMR. These responses are not considered further in this Feedback Statement or the Statement of Policy for Article 23D. We encourage firms to engage with us as and when we consult on any decision to use Article 23D power, or other new BMR powers and as we look to put in place our Statements of Policy and decisions.

2.92 Respondents also commented on safe harbour and protection for the benchmark administrator which are matters outside FCA's powers under the BMR. We are unable to comment on these matters. HM Treasury has published a consultation on these issues seeking views on whether a legal safe harbour could be a helpful supplement to the provisions inserted into the BMR by the FS Bill.

3 Potential implications of proposed policy applied to LIBOR

3.1 Our consultation set out our provisional position on approximating the value of LIBOR by using 2 components: a forward-looking term RFR plus a 5-year historic median of the spread between LIBOR and relevant RFRs (ie the approach adopted by ISDA).

3.2 We did not specifically seek market views as we intend to consult in Q2 2021 on our prospective decision to apply our Article 23D powers to certain LIBOR currency-tenor settings. However, we received a number of responses as below.

3.3 Most respondents supported our proposed approach. Five respondents highlighted the importance of synthetic LIBOR being as economically similar to LIBOR as possible, including for it to remain LIBOR on screen in order to avoid a disorderly transition.

3.4 One respondent suggested that while the proposed methodology is suitable for the short-term, we may need to revisit its appropriateness in the long-term because the 'lookback' period is during a period of unprecedented liquidity provision by central banks.

3.5 One respondent suggested that we consider a changed methodology to be based on an RFR compounded in arrears as the first component. One respondent suggested that a synthetic rate based on an RFR compounded in arrears would be suitable if there was to be a wider definition for 'tough legacy', while one based on a term RFR would be suitable if the definition of 'tough legacy' is narrow.

3.6 Two respondents suggested that we consider a dynamic credit spread for the second component of the methodology to help with tough legacy in specific market segments.

Our response:

3.7 We intend to consult in Q2 2021 on whether and precisely how to apply our Article 23D powers to certain LIBOR currency-tenor settings. We encourage all those affected by LIBOR transition to respond to that consultation.

3.8 Our proposal to base a 'synthetic' LIBOR on a forward-looking term RFR is intended to replicate the forward-looking measure of expected interest rates that is reflected in LIBOR itself. We note that there are some advantages in using a compounded-in-arrears RFR, but this would result in changing the calendar period over which interest rates were measured. This would mean the synthetic rate was less likely to be effective in approximating the value that LIBOR would have had.

3.9 Attempting to include a dynamic credit spread to a 'synthetic' rate would be inconsistent with the market consensus on a fair way of establishing a replacement value for LIBOR. Moreover, it is unclear that a suitably robust measure of dynamic credit spreads is available. Some ways of estimating such a spread, for example based on prices in securities and commercial paper markets, which are also affected by liquidity conditions, could display a degree of volatility that would be difficult to reconcile with our objective of protecting consumers.