FINANCIAL CONDUCT AUTHORITY

Feedback Statement: FCA use of powers over use of critical benchmarks

Feedback Statement

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1 Introduction

Summary

1.1 In May 2021, we published a consultation seeking views on how we proposed using 2 new FCA powers introduced through amendments to the Benchmarks Regulation (BMR) under the Financial Services Act 2021 (FS Act). These powers relate to the restriction of use of critical benchmarks that are being wound down. The powers are part of a wider package of amendments to the BMR in the FS Act. This package is intended to ensure that the FCA has the appropriate regulatory powers to help reduce risk when a critical benchmark is being wound down. Our overview document sets out the background to the BMR and the amendments introduced by the FS Act.

1.2 An Article 23A benchmark is permanently unrepresentative of the market it is intended to measure and is in the process of being wound down. The BMR prohibits its use, but it also empowers the FCA to permit some or all use of the Article 23A benchmark in legacy contracts to continue, where we consider that it is desirable to do so to advance 1 or both of our consumer protection and integrity objectives. We call this the 'legacy use power'. We consulted on our proposed policy for considering whether and how to exercise this legacy use power.

1.3 We also consulted on our proposed policy for the exercise of our power under Article 21A of the BMR. This gives us the ability to prohibit some or all new use of a critical benchmark when we have been notified by its administrator that it will not be published in the future. We can only exercise our new use restriction power to advance either or both of our consumer protection and integrity objectives. We call this the 'new use restriction power'.

1.4 This Feedback Statement summarises the feedback we received and our response. It should be read alongside our Statements of Policy on our legacy use power and new use restriction power.

Defining terms

1.5 'Use of a benchmark' is defined at Article 3(1)(7) of the BMR. This use can take place in relation to financial instruments, financial contracts and investment funds. For ease of reference, throughout this feedback statement we refer to use in 'contracts'. By this we mean 'use in financial instruments and financial contracts and by and for investment funds'. Please read 'user' in the same way.

Who this affects

1.6 This Feedback Statement will interest users of critical benchmarks, whether these users are regulated or unregulated. This includes:

- banks and building societies
- investment managers
- life insurance and pension providers
- mortgage lenders and intermediaries
- corporates of all sizes
- consumers who have mortgages and other consumer loans that use critical benchmarks

1.7 It will also interest administrators of critical benchmarks.

1.8 As we set out in our consultation, these powers will only directly affect entities and contracts within the scope of the BMR. Non-supervised entities such as non-UK firms, non-financial corporations or retail consumers may be party to existing contracts that are affected by a prohibition on use of an Article 23A benchmark. Such prohibition, if not overridden through the exercise of our legacy use power, may trigger or otherwise interact with contractual terms or fund management measures and/or documents that apply to both parties.

The wider context of this feedback statement

Our consultation

1.9 Under Articles 23F(1)(a) and (c) of the BMR, we must publish a relevant Statement of Policy before we exercise either of these new powers over critical benchmarks. We must have regard to these Statements of Policy when exercising our powers and are obliged to explain how we have done so.

1.10 We discourage the use of permanently unrepresentative benchmarks where appropriate alternatives are available. Users should stop using them wherever they can.

1.11 We remind market participants that it is important for them to take all necessary steps to ensure that they understand how their contract terms interact with the winding down of a critical benchmark. It is up to parties to take their own legal advice on the exact wording of their contracts.

1.12 Similarly, if the FCA decides to exercise its new use restriction power, it is important that market participants understand if and how it will impact them and take the necessary steps.

1.13 In this document, we are setting out the feedback we received to the consultation and our response.

How it links to our objectives

1.14 The new BMR provisions stipulate that we may only exercise our legacy use and new use restriction powers if we consider it is desirable to do so in order to advance either or both of our statutory objectives to:

- secure an appropriate degree of protection for consumers
- protect and enhance the integrity of the UK financial system

The 'integrity' of the UK financial system includes its soundness, stability and resilience and the orderly operation of the financial markets.

Summary of feedback and our response

1.15 We received 42 responses from banks, asset managers, trade bodies, and law firms, with most of respondents from the UK and some from abroad.

1.16 Although the consultation proposed a general policy for winding down any critical benchmark, most of the feedback we received was framed in the context of winding down LIBOR specifically. This is understandable given that LIBOR is currently the only critical benchmark in the UK. We interpret and apply this feedback in the context of a general policy: in some cases we have framed our responses below by reference to LIBOR specifically.

1.17 A number of comments received from respondents referred to non-consumer loans. As we set out in our consultation, these powers will only directly affect entities and contracts within scope of the BMR. Loans that are covered by the definition of a financial contract at Article 3(1)(18) of the BMR (ie credit agreements and regulated mortgages) are subject to the BMR. Products outside of the scope of the BMR, including loans that are not captured by the definition above, are not directly affected by any prohibition imposed by its provisions. Taking a wider consumer protection and market integrity risk perspective, however, we continue to discourage the use of permanently unrepresentative benchmarks where appropriate alternatives are available - even where robust fallbacks are in place. All users should stop using them wherever they can move to fair and robust alternatives.

1.18 Overall, most respondents agreed with our proposals. Some respondents argued that some factors would not be relevant in certain circumstances. We are retaining all the factors we consulted on as they are potentially relevant factors for our policy making for future critical benchmarks. We agree that not every factor will be relevant in all cases. As stated in our consultation, the prevailing circumstances at the time of making a decision may make it desirable or appropriate to take account of some of these factors only, or to take account of additional or alternative factors, or both.

1.19 Following the feedback received, we have included an additional factor that may be relevant when deciding whether and how to exercise our legacy use power. When determining the feasibility for parties to amend contracts (or to otherwise remove reliance on an Article 23A benchmark), we may consider whether the contract is explicitly and/or structurally linked to another use of the benchmark, and this creates a barrier to amending the contract in a manner that 'matches' the linked contract.

1.20 We have also expanded 1 of the existing factors. We agree that parties' likely awareness, knowledge and understanding of the process for amending the contract is also relevant, in addition to their likely awareness, knowledge and understanding of Article 23A designation.

1.21 We did not add or amend any factors in our Statement of Policy on our new use restriction power.

Equality and diversity considerations

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

Next steps

1.23 We have published the finalised Statements of Policy setting out factors we consider may be relevant when making decisions on whether and how to exercise our legacy use power (Article 23C of the BMR) and new use restriction power (Article 21A of the BMR). We will have regard to these Statements of Policy whenever we exercise our powers and will explain how we have done so.

2 Permitting continued use of the benchmark in legacy contracts

2.1 An Article 23A benchmark is permanently unrepresentative of the market it is intended to measure and is in the process of being wound down. Article 23B(1) of the BMR prohibits its use.

2.2 However, Article 23C(2) empowers the FCA to permit some or all use of the Article 23A benchmark for legacy contracts, where doing so would advance 1 or both of our consumer protection and integrity objectives.

2.3 We consulted on our proposed policy for considering whether and how to exercise our legacy use power. This chapter sets out the feedback received and our response.

> **Q1:** ***What kinds of provisions do you consider would lead to unintended, unfair or disruptive outcomes, or prove inoperable in practice, if a critical benchmark could no longer be used?***

2.4 Many respondents provided information on fallbacks that they think will lead to unintended, unfair, disruptive or otherwise inappropriate outcomes, or will be inoperable, generally. Some went on to explain which of these would be triggered by a prohibition on use. For example, some gave examples of fallbacks that may be triggered when a benchmark is not published, but these fallbacks would not be triggered by a party to the contract being prohibited from using the benchmark. Some respondents suggested we should remedy inappropriate or inoperable fallbacks by exercising our legacy use power.

2.5 One respondent referred to illegality and termination style events triggered by a prohibition on use.

2.6 Some specific examples of contract clauses that would be triggered by a prohibition on use were provided. In relation to bonds, 1 example was of illegality clauses that require the bond to be called, which the respondent concerned argued would be disruptive to the market if occurring in large volumes and could have negative consequences for accounting and capital treatment. Another similar example was where the prohibition could be considered to trigger an event of default, which could lead to redemption of the bond at par, and possibly trigger cross defaults in an issuer's other borrowings.

2.7 Some respondents identified 'Type 2' bonds specifically and said these provide for the issuer to appoint an independent agent to select an alternative rate following a prohibition on use of the benchmark. However, the drafting of the fallback is likely to vary from bond to bond. The operation of such a prohibition fallback would be likely to result in a bond moving to an appropriate alternative rate, but would require costs being incurred and practical challenges. If fallbacks are triggered in bonds due to a prohibition on use, this may result in mismatches of cashflows within securitisation or repackaging structures that involve other products; this could also create significant practical challenges.

2.8 For derivatives, some respondents said that they are likely to contain illegality clauses that may be triggered by a prohibition on use, but that it will not always be clear whether these clauses are present and whether they are triggered. Some suggested that where these clauses exist in derivatives, they may require early termination which, some argue, would be disruptive to the market if occurring in large volumes of contracts and would end hedging arrangements for counterparties prematurely. (The effect of prohibition on hedging arrangements is discussed on page 11.)

2.9 Other suggestions were that prohibition could trigger 'force majeure' provisions, which parties might argue should operate even where a fallback could possibly be triggered; or it could generate uncertainty as to whether or not fallbacks had been triggered, leading to disruption. This could include 'opportunistic' parties arguing for a favourable interpretation.

Our response

The feedback provides useful examples on how a prohibition on use of a critical benchmark can be disruptive and have negative consequences.

The ability to remedy inappropriate or inoperable fallbacks by exercising our legacy use power is available to us where the fallback would be triggered by the prohibition on use of an Article 23 benchmark, but not otherwise. Where the fallback is triggered by some other action or circumstance then our legacy use power will not be relevant.

For instance: if the trigger is the permanent unrepresentativeness of the benchmark, the contract will likely move to the fallback as a consequence of the Article 23A designation taking effect. The exercise of our legacy use power would have no effect and would thus not be relevant.

If the trigger is permanent cessation of the benchmark, the fallback is not likely to be triggered while a benchmark continues to be published as an Article 23A benchmark. However, at some point the benchmark will stop being published (an Article 23A benchmark is by its nature in the process of being wound down) and at that point the fallback will be triggered, unless the contract has been amended.

Bonds with fallbacks that have provisions for the issuer to appoint an independent agent to select an alternative rate and appropriate credit adjustment spread following certain trigger events would potentially transition to a more appropriate alternative rate upon a prohibition on use. While there would be considerable process attached to this, most of the steps involved are also likely to be necessary in the course of amending the contract. As an Article 23A benchmark is by nature in the course of being wound down, movement to an alternative will be necessary at some point. We accept, however, that bond documentation is not standardised and bondholders are unlikely to know whether their contracts contain provisions of this sort without a bond-by-bond analysis. This bond-by-bond analysis would be a lengthy and complicated process that could leave parties in limbo.

We understand that some contracts contain illegality clauses or termination style events that could be triggered upon a prohibition of use, and that these could lead to inappropriate or inoperable outcomes with disruptive or harmful consequences, particularly if they take effect in large numbers of contracts all at once. Furthermore, there could be widespread uncertainty as to whether and how many contract provisions are triggered and apply in the event of a prohibition which could lead to litigation, including by parties seeking to use this uncertainty to their advantage. Therefore, these contract provisions have the potential to create market disruption, a threat to consumer protection, and/or financial instability.

However, this potential risk will be avoided if contracts are amended to an alternative rate ahead of the designation as an Article 23A benchmark. When assessing the scale and the nature of legacy contracts that do not have adequate provisions to deal with a prohibition on use, we will take account of the potential risks posed by these provisions while also considering whether and to what degree it is feasible for parties to amend these contracts, using the factors discussed below.

Q2a: ***Do you think the factors in 2.11 are relevant to determining whether or not it is feasible to amend contracts?***

Q2b: ***Where you do not think a factor is relevant, please explain why.***

Q2c: ***Are there any other factors not listed that are relevant?***

2.10 All but 2 of the factors identified in the consultation were agreed as being relevant by the majority of respondents.

2.11 Some respondents felt it would not be appropriate to consider 'evidence of similar contracts being amended' because each contract has unique characteristics and provisions, making it difficult to judge the feasibility of amendment on the basis of other contracts having been successfully amended. Circumstances such as the intended economic outcome, location / jurisdiction, distribution and type of counterparty and the purpose of the instrument were all said to have an impact on the likelihood of successfully amending a contract.

2.12 A significant number of respondents also raised concerns with using the notice parties have had of the prohibition (or the likelihood of such) as a factor. This was because there may be instances where it is not possible to amend the contract (eg to achieve a successful consent solicitation for bonds) despite the amount of notice parties have had – because there are other obstacles to successful amendment besides the necessary lead time. For example, it may not be possible to identify all bondholders, despite the time available to do so. Other respondents also noted that firms had different levels of access to market intelligence and technical expertise that may mean they require differing amounts of time to transition.

2.13 Some respondents argued that our proposed 'awareness' factor was too narrow by focussing on retail borrowers and did not capture other situations where benchmark

users may have low levels of awareness, knowledge and understanding of Article 23A designation. Another said the factor should be expanded to include the parties' likely awareness, knowledge, understanding of, and access to, available mechanisms for amending the contract.

2.14 One respondent argued that contracts that can be amended via unilateral variation should not be considered to be impracticable to amend to remove reliance on the Article 23A benchmark; nor should contracts that need the consent of the borrower, unless the lender has evidence that borrowers would not accept proposed transition terms even if they included a reasonable incentive.

2.15 A number of respondents suggested an additional factor should be whether contracts are directly linked to other contracts. Examples of linked contracts provided were: complex transactions involving interconnected products such as securitisations or collateralised loan obligations; the alignment between the performance fee of an investment fund and the return on the underlying holdings; and contracts used to hedge other products. If a contract is linked to 1 or more other contracts that use the Article 23A benchmark and cannot feasibly transition away (or have not done so yet), then it may not be clear what alternative rate the contract should move to. Changing the first contract such that it no longer 'matches' the other contract(s) to which it is linked could change the economic terms of the transaction and thus possibly lead to litigation or disruption.

2.16 Respondents also gave other examples of barriers to amending contracts which they thought should be taken into consideration. These included: where there is a third-party dependency, eg approval from an authority is needed to amend the contract; where use of industry-recommended alternative benchmarks (and / or documentation) might not be suitable for certain products; and asymmetries in the bargaining position of parties to contracts when negotiating changes, given that the prohibition only applies to entities and contracts within scope of the BMR, and parties affected will be under significant pressure to settle.

2.17 Two respondents highlighted contract terms that provide for a benchmark to be used at a future point in time. One example was a bond in respect of which payment calculations are based on a fixed rate initially but after a specified period of time the calculation moves to use of the benchmark – unless the bond is called prior to the date of transition to the benchmark. Another was of a penalty or 'break' clause in a contract, that provides for the use of the benchmark in circumstances where the clause is triggered and requires calculation of a payment. They queried how these would interact with the prohibition on use and the exercise of the legacy use power.

2.18 One respondent noted that amending the contract is not the only avenue for removing reliance on an Article 23A benchmark: other routes, such as termination or replacement, might be available.

Our response

We accept that contracts are often diverse and bespoke in nature, even within asset classes. Thus, we note that similarities between products do not always indicate similarity between contract terms. However, where contracts are genuinely similar, eg where use of the benchmark is concentrated in products using highly standardised documentation,

evidence that similar contracts have been amended can still be a helpful indicator in certain circumstances to consider the overall feasibility of amending a contract. We will therefore retain the factor.

We understand that, in certain circumstances, explicit and/or structural linkages between contracts where some elements can transition, and others cannot, could be disruptive. For example, if a derivative is embedded within a structured transaction, and other components cannot transition, permitting use for the derivative might be needed to maintain the precise cashflow. We are therefore adding another factor for determining the feasibility of amending a contract. This is whether a contract is explicitly and/or structurally linked to other use of the benchmark, and this creates a barrier to amending the contract in a manner that 'matches' the linked contract and thus maintains the economic terms of the transaction. However, we have reservations as to whether all of the examples provided should always be regarded as explicit and/or structural linkages.

Where a contract is used as a hedge for another product or contract there is unlikely to be an explicit link in the contractual terms of either contract; and we would not necessarily view the contracts as being structurally linked. We note respondents' concerns that contracts being hedged by the derivative could be left either unhedged or inadequately hedged - which could result in breach of covenants and thus trigger defaults and resulting downgrades of credit ratings. However, this will not always be the case: in many instances we think there could potentially be mechanisms available whereby a satisfactory hedge could be provided without directly 'matching' the benchmarks being referenced. We expect firms to consider this carefully and conduct a robust analysis of alternatives.

With investment funds, the benchmark being used to calculate payments on some of the underlying investments may be relevant when selecting an appropriate benchmark by which to measure the performance of the fund itself for the purpose of calculating performance fees. However, we think other considerations may well be relevant too. Therefore, where the benchmark being used by some of the underlying investments is an Article 23A benchmark, and an alternative rate has not yet been selected for these, it may nevertheless be possible to select an appropriate alternative benchmark for the calculation of fees.

The 'awareness' factor was intended to recognise that there may be some types of counterparty who have low awareness, knowledge and understanding of Article 23A designation. We gave the example of retail borrowers in the consultation for illustrative purposes, rather than as an exhaustive category. We agree that, in reality, there are likely to be other user groups to whom this applies (perhaps including, but not limited to, some SMEs and non-financial entities). We have extended the non-exhaustive list of examples in our policy to reflect this. We have also amended the factor to cover parties' awareness, knowledge and understanding of the mechanisms for amending the contract because

we agree that this could also impact the feasibility of amending a contract.

We think that for many contracts, amendment is possible but requires a lengthy process and/or a considerable volume of work. For these contracts, we think that the notice period parties have had is a relevant factor when considering whether contracts can be amended or not. However, we recognise that in some instances, parties to contracts face very difficult and possibly insurmountable obstacles to amending them successfully.

We agree that both third-party dependencies and asymmetries in parties' negotiating positions can be barriers to amending a contract. However, we think our existing factors cover these situations. Our factors consider the ease of amending the contract, including any legal, regulatory or operational procedures required for the relevant parties to consent; and the effect of the prohibition on parties who must consent to, or be involved in, amending the contract. This includes whether the prohibition on use affects parties differently so that it creates misaligned incentives to amend the contract on fair terms.

We agree that industry-recommended alternative benchmarks may not always be suitable for certain products, and there may be occasions where there is genuinely no other appropriate alternative benchmark available. This is why we have included a factor on whether appropriate alternatives are available.

We consider that the examples provided of contract terms that reference a benchmark for the purpose of using it at a future point in time are likely to be regarded as legacy use and so the FCA could permit it to continue. Our Statement of Policy sets out the range of factors that are likely to be relevant when we decide whether or not doing so is appropriate.

We also recognise that there may be other avenues to removing reliance on an Article 23A benchmark and we have reflected this in our Statement of Policy. However, we think there may be similar obstacles to implementing these options on fair terms, such that they may not always be feasible in practice – and that this would be accounted for through our existing factors on 'feasibility'.

Q3a: ***Do you think there may be situations where we could or should only permit a limited form of continued use of the benchmark?***

Q3b: ***Please explain your answer.***

2.19 One of the examples in our consultation was a time-limited permission. Views from respondents were roughly evenly split between those who thought that time-limited permission would not enable parties to contracts to resolve issues and amend contracts, and those who thought that a broad time-based limit would be sufficient to allow for an orderly transition away from the Article 23A benchmark.

2.20 Respondents opposed to a time-limited permission said that some contracts can't be amended regardless of the time available. One respondent commented that any criteria used to define time limits or the pool of contracts to which they apply should not lead to confusion and cliff edges. Another noted that for LIBOR specifically, a time limit on legacy use would not be consistent with the approaches taken by EU and US authorities.

2.21 Another respondent raised concerns regarding the Solvency II regulation relating to insurers holding matching adjustment portfolios, if a time limit is applied to any permission, because they think it would be difficult to prove that the required cashflow can be maintained beyond the specified deadline (as the future cashflow would be unclear).

2.22 On the other hand, some respondents highlighted that a time limit could be helpful for contracts that could in theory be amended but need extra time. This would help overcome volume and capacity issues where a large number of contracts need to transition at the same time, and it is not possible to complete the necessary amendment procedures, eg consent solicitations, before prohibition of use would come into effect.

2.23 Many respondents agreed that a final termination payment should be allowed at a minimum, but also said it would be important to consider the impact of triggering such provisions en masse.

Our response

In the consultation, we gave 2 examples of how we could permit some limited form of continued use of a benchmark; that is, a time-limited permission, or permission to use the benchmark to calculate a final termination payment. These examples were not intended to be exhaustive and there could be other forms of limited permission that might be appropriate in some circumstances.

While we recognise that there may be specific circumstances where a time-limited form of continued use would not enable a contract to be amended, we think it could be relevant in some cases and so we might want to consider it as an option. Given this, and respondents' agreement on the possible need to use the benchmark for a final termination payment, we intend to retain this factor to allow us to consider whether forms of limited use – including, but not limited to, these examples – might be appropriate. However, we may need to balance consideration of a limited form of permitted use against other factors, such as the degree to which we can define clear and practicable criteria for when use is permitted and when it is not permitted.

Regarding matching adjustment portfolios and Solvency II regulations, the example given related to loans outside of the scope of the BMR definition (see 1.17 above). To the extent the same issue could impact in-scope instruments, our new factor on 'structural and/or explicit linkages between uses of the Article 23A benchmark' might be relevant. However, we do not think a time-limited permission in itself introduces the issue of cashflow uncertainty; we assume insurers

could potentially face the same issue before the FCA has made any decision to permit legacy use of an Article 23A benchmark, or when considering what will happen after the Article 23A benchmark permanently ceases (depending on the contract terms of the affected instruments). Any firm with a question on the application of the Solvency II matching adjustment regulation should speak to its usual Prudential Regulation Authority supervisor.

Q4a: ***Do you think the considerations in 2.14 are relevant to determining whether it would be desirable to exercise our legacy use power?***

Q4b: ***Where you do not think a consideration is relevant, please explain why.***

Q4c: ***Are there any other considerations not listed that are relevant?***

2.24 Many respondents agreed with the further considerations identified in the consultation. There was strong support for retaining 'international consistency' and 'the degree to which we can set out clear and practicable criteria for the market' as key considerations.

2.25 A significant number of respondents said that 'whether contracts are required by law or regulation to contain suitable fallback provisions but there has been non-compliance' was not a relevant consideration on whether legacy use should be permitted. One respondent argued that there was a need to separate the outcomes sought with this policy and whether a party failed to meet regulatory requirements. In relation to LIBOR specifically, another respondent suggested that only a small proportion of legacy bonds that may be considered to be impracticable to amend would have been required to contain robust fallbacks when they were issued.

2.26 Similar to responses to Q2 (see 2.15 above), several respondents suggested that an additional factor to consider was the interconnectedness of contracts in complex structures like securitisations. All instruments in such structures had to be permitted to continue using the benchmark to avoid cashflow mismatches.

2.27 Two respondents highlighted the potential conflict of interest for market participants arising from the use of a benchmark that is used as an input to the Article 23A benchmark. One suggested that in these cases, we should consider not permitting legacy use.

Our response

We think it important that we can take account of non-compliance with requirements when we make decisions. Non-compliance with legal and regulatory requirements is a serious breach of firms' obligations and the FCA must be able to take such breaches into consideration. We must be able to consider whether our powers can and should be used in a manner that helps bring about compliance. Where not permitting legacy use of the benchmark for non-compliant firms would not cause market

disruption (for example, if non-compliance was limited to a small sub-set of affected contracts), we might judge that not permitting legacy use of the benchmark is appropriate given the non-compliance.

However, we recognise there may be scenarios where we might need to intervene to address consumer protection or integrity risks that could arise from a prohibition on use. Where this is the case, we might opt to permit legacy use for a transitional period but with conditionality aimed at addressing the non-compliance.

With regard to the application of the BMR to LIBOR specifically, where contracts that are within scope of the Regulation were entered into before the provisions of Article 28(2) came into force, firms should amend them 'where practicable and on a best-effort basis' (see Q&A 8.1 here). They should be prepared to provide details of their efforts in this regard to their supervisors upon request. We have made this clear in our Statement of Policy.

We recognise the risk of a conflict of interest where a firm that uses a benchmark is active in the markets measured by that benchmark. It is incumbent on market participants to take adequate steps to mitigate this risk. There are provisions in the Market Abuse Regulation and the BMR, as well as FCA rules, that require UK regulated entities that participate in these markets to identify conflicts of interests and appropriately manage them, and undertake surveillance to identify and report any suspected or attempted manipulation of the benchmark. Activity by regulated entities in the markets being measured is subject to regulatory requirements and oversight, including transaction reporting.

As set out in our response to Question 2 (see page 11), we agree that links between uses of a benchmark can create barriers to amending a contract in a manner that 'matches' the linked contract in some cases. We have added a factor to our Statement of Policy to reflect that this may be relevant when determining the feasibility of amending a contract.

Q5: ***Are there any other considerations not listed that are relevant?***

2.28 Many respondents highlighted the importance of consistency between jurisdictions in approaches to permitting legacy use.

2.29 One respondent sought clarity on whether the Article 23A benchmark could be relied upon indefinitely or whether firms should continue to reduce exposures.

2.30 One of the responses asked us to provide clarity in our policy on whether there are any circumstances in which it is acceptable not to make any efforts to transition away from an Article 23A benchmark; and to provide guidance on what constitutes 'reasonable efforts' to transition.

2.31 Another pointed out that the maximum period of time that an Article 23A benchmark is likely to be sustained appears to be 10 years and asked for clarity on what action should be taken for contracts maturing beyond this period. One respondent suggested that it would be sensible to align any announcement of Article 23A designation with announcement of our decision as to what legacy use of the benchmark we plan to permit - because there could be legal risk attached to continued use of an Article 23A benchmark.

2.32 In relation to LIBOR, many respondents said it was important to get clarity on the FCA's approach as soon as possible to advance their transition work. Another suggested that if the FCA was to use its new powers (under Article 23D(2)) to require a change to LIBOR's methodology, then it should consider how it would act where there are multiple providers of a required input to the benchmark; and another appeared also to be referring to the methodology change power when commenting that moving to a rate based on an RFR compounded in arrears would be problematic for some users and contract provisions. These last points do not relate to our legacy use power but are more relevant to our decisions on our use of the Article 23D(2) power and press release setting out our choice of term rate provider for GBP LIBOR.

Our response

We agree with the importance of international consistency, and have retained this in the list of relevant factors we may consider when deciding whether to exercise our legacy use power.

Firms should assume that Article 23A benchmarks will not be published indefinitely. As we set out in our consultation, they are permanently unrepresentative of the market they are intended to measure. Their continued publication may depend on requirements we impose on the administrator (the BMR empowers the FCA to require continued publication of a critical benchmark, and to require the administrator of an Article 23A benchmark to make changes to the benchmark, including to its methodology).

Any such requirements would be subject to regular review, and in any case time limited, so there can be no certainty as to how long the benchmark will continue to be published. Therefore, we have been very clear that where firms are able to take steps towards transitioning away from an Article 23A benchmark, including by amending their contracts, they should do so. We think firms should be able to identify what steps they can take in this regard and should be making best efforts to implement these.

As we set out in our consultation - and reflect in our Statement of Policy - where contracts are in scope of the BMR, they should already contain robust fallback provisions for both cessation and material change. If in-scope contracts were entered into before the provisions of Article 28(2) came into force and did not contain such provisions, firms should be amending them 'where practicable and on a best-effort basis' as per Q&A 8.1 here. It is for firms to satisfy themselves that they are making best efforts and to be prepared to demonstrate how they are doing so to their supervisors. The requirement to take steps to transition away

applies, but is not limited, to long-dated contracts that are unlikely to mature before the Article 23A benchmark ceases to be published.

Alongside this Feedback Statement, we have published Statements of Policy, including in relation to our legacy use power, and a consultation setting out our proposed decisions on the application of this policy to LIBOR specifically. These should provide clarity to the market on our policy and our proposed application of it to LIBOR.

We intend to confirm our final decisions for LIBOR as soon as practicable in Q4 2021. We encourage market participants to continue to transition away from LIBOR wherever possible and in line with relevant industry milestones, and not to delay their plans by waiting for a 'synthetic' solution, given the limitations outlined above.

The timing and content of public announcements relating to our decisions regarding Article 23A designation and its consequences will be determined on a case-by-case basis according to the particular benchmark in question and the circumstances prevailing at the time.

3 Restricting new use of a ceasing critical benchmark

3.1 Where the administrator of a critical benchmark has notified us that the benchmark will cease to be provided, new Article 21A of the BMR enables us to prohibit some or all new use of the benchmark by supervised entities during any wind-down period before it ceases.

3.2 Our new use restriction power can be exercised in relation to any ceasing critical benchmark, except where the benchmark has already been found to be unrepresentative and designated as an Article 23A benchmark – in which case all new use within scope of the BMR will be prohibited by Article 23B(1).

3.3 We can only exercise our new use restriction power where we consider that doing so would advance either or both of our consumer protection and integrity objectives.

3.4 In our consultation we set out our proposed policy for considering whether and how to exercise our new use restriction power. This chapter sets out the feedback received and our response.

> **Q6a:** ***Do you think the factors in 3.5 are relevant to determining whether new use of a ceasing critical benchmark could be a risk to consumer protection and/or market integrity?***
>
> **Q6b:** ***Where you do not think a factor is relevant, please explain why.***
>
> **Q6c:** ***Are there any other factors not listed that are relevant?***

3.5 Most respondents broadly agreed with the factors listed.

3.6 Some respondents said that the nature and/or degree of activity in the market(s) underpinning the ceasing critical benchmark would not be a relevant factor if there are no viable alternatives to use. Some respondents also argued that limited confidence and liquidity in alternative benchmarks and/or market preparedness to use them should not be a reason to restrict new use of a ceasing benchmark, rather it would be a reason not to restrict use.

3.7 One respondent did not think the factor on 'whether the benchmark is expected to remain representative for the entirety of the wind-down period' was relevant. This assumed that an assessment would have been made on the representativeness of the critical benchmark at the point at which the cessation announcement was made. As a result, clarity would have been provided to the market on timing for the wind-down period in order to provide an orderly transition away from the ceasing critical benchmark.

3.8 Some respondents suggested that international consistency should be a factor in this section; for example, 1 respondent thought action by other authorities to restrict use of ceasing benchmarks could impede our ability to meet our objectives.

3.9 A small number of respondents also thought that liquidity will move to alternative benchmarks naturally and/or through market initiatives, without the FCA needing to use this power.

Our response

These factors will not be considered in isolation. As set out in the consultation, determining whether to restrict new use may include balancing the availability of alternative benchmarks against the need to build up the necessary market infrastructure and liquidity to support their use. This may also be balanced against other relevant factors in the Statement of Policy.

We are not required routinely to perform a representativeness assessment of a ceasing benchmark except where the FCA decides to compel the administrator to continue publishing the benchmark. We cannot rule out a situation in which we have concerns as to whether a benchmark will continue to be representative throughout the entire planned wind down period. In these circumstances, we might consider it prudent to stop new use in advance.

We are therefore retaining all the factors we consulted on in this section.

We think that other authorities are unlikely to take action to restrict new use of a ceasing benchmark that creates risks to market integrity or consumer harm. However, we agree international consistency is an important factor we may need to consider in deciding whether and how to use our new use restriction power. We have therefore retained it as a factor in our Statement of Policy. If other authorities have taken such action, it may also impact the scale of potential new use of the ceasing benchmark by UK supervised entities, and therefore have a 'knock on' effect on our assessment of the potential risks of new use of the ceasing benchmark. This would be considered as part of our assessment.

We recognise that liquidity may move to alternative benchmarks without our intervening. There may also be occasions where an intervention would encourage the development of liquidity. As above, the scale of potential new use is something we would consider in determining whether intervening would be desirable to advance our integrity and / or consumer protection objectives.

Q7a: ***Do you think there may be situations where we could or should impose a limited form of restriction (eg for certain contract maturities; certain types of product or user, or after a defined time period)?***

Q7b: ***Please explain your answer.***

3.10 Most respondents agreed that there may be situations where we could or should impose a limited form of restriction on new use of a ceasing benchmark, rather than a blanket ban. However, some noted the importance of ensuring there are very clear criteria for any limited restriction.

3.11 Of these respondents, a handful noted specifically that allowing new use of the benchmark only in short-term contracts could be a helpful bridging solution where the market is still preparing to use alternative benchmarks. Some respondents also thought that this sort of time-based prohibition would be the easiest type of limited restriction to implement from an operational perspective.

3.12 Where respondents did not support a limited form of restriction, it was on the basis that it would be difficult to formulate limited restrictions on new use without creating unintended, disruptive or unfair outcomes. One respondent thought that trying to distinguish between products and users could have implications in terms of treating market participants and their customers fairly.

3.13 Other comments included that any limited restriction should be product and counterparty agnostic; and that any limited restrictions should align with those imposed by other international authorities. Multiple respondents said that if a limited form of restriction was imposed it would be important to provide sufficient lead time for users to prepare.

3.14 Some respondents also provided suggestions about how our policy should be applied to LIBOR. Some of that feedback is more relevant to our specific decision in relation to LIBOR than to our Statement of Policy, and we have taken account of it when considering our proposed decision in relation to LIBOR.

Our response

We think it is sensible to retain the option to consider whether a limited form of restriction on new use of a ceasing benchmark might be appropriate. We agree with the feedback received on how we could impose such restrictions and in which situations, as well as the potential drawbacks this may entail. Any limited form of restriction may need to be balanced against other factors in our Statement of Policy, such as international consistency, the degree to which we can set out clear and practical criteria for the market, and what the appropriate lead time would be.

In addition, as set out in the consultation, we think new use of a ceasing benchmark could still create potential risks to consumer protection and market integrity, even where new contracts contain robust fallbacks (which is already required under Article 28(2) of the BMR).

Q8a: ***Do you think the considerations in 3.9 – 3.13 are relevant to determining whether not intervening in respect of certain new use of the ceasing critical benchmark might support consumer protection or market integrity?***

Q8b: ***Where you do not think a consideration is relevant, please explain why.***

Q8c: ***Are there any other considerations not listed that are relevant?***

3.15 The vast majority of respondents agreed that both considerations were relevant. Some went on to highlight the importance of ensuring that the considerations used were consistent with those used by other international authorities.

3.16 Regarding the availability of alternatives, some respondents noted that different alternatives may be needed across different products. One respondent specifically said it would be important to consider the availability of alternatives for corporate users of the benchmark, as well as retail consumers.

3.17 One respondent did not think the 'availability of alternatives' was a relevant factor, but this was in the context of LIBOR given there are recommended replacement rates in all LIBOR currencies.

Our response

We have retained the considerations listed in the consultation. We agree with respondents' feedback that the consideration as to whether users have access to suitable replacement benchmarks may need to take into account different users and uses of the ceasing benchmark.

If we were to impose a restriction that covered only some types of new use, we would need to be confident that we could set clear and practicable criteria that distinguished between permitted and prohibited use.

Q9a: ***Do you think the additional factors in 3.14 are relevant in determining whether and how exercising our new use restriction power would advance consumer protection and/or market integrity?***

Q9b: ***Where you do not think a factor is relevant, please explain why.***

Q9c: ***Are there any other factors not listed that are relevant?***

3.18 The majority of respondents agreed with the additional factors identified, with a number emphasising the importance of international consistency. This is because of the global nature of many markets, the cross-jurisdictional presence of many firms, and the need to ensure a level playing field for UK firms. For this reason, some respondents said that international consistency should be a 'key' factor, rather than an 'additional' factor.

3.19 One respondent said there may be merit in not using the new use restriction power at all if it would allow for better international alignment. Similarly, 1 respondent said that if other authorities were taking a less strict approach to restricting new use of a ceasing benchmark, it could disadvantage UK supervised entities and disrupt liquidity globally.

3.20 One respondent also recognised that there may be exceptions to international consistency where a product / benchmark is only used by UK entities.

Our response

We have retained the factors proposed in the consultation. As mentioned previously, we agree international consistency is an important factor we will likely need to consider. We also recognise the potential impact if authorities take inconsistent approaches to restricting new use of a ceasing critical benchmark. We did not intend the word 'additional' to mean the factor was less important than other factors, so have amended the wording in our Statement of Policy to make this clearer.

Q10: ***Are there other relevant factors or considerations we have not reflected in our proposed policy approach to use of our new use restriction power?***

3.21 While respondents didn't suggest any further substantial factors, 1 respondent reinforced the importance of considering how engrained a critical benchmark is in the market if considering whether to restrict new use. Three respondents called for more contract standardisation in cash markets to ensure the move to alternative benchmarks can be made more effective in future, if needed.

3.22 A small number of respondents said that advanced notice that the benchmark is likely to cease doesn't appear to be a robust ground for imposing a shorter implementation period. Some respondents noted that market participants are not likely to have sufficient detail on when and how the benchmark is likely to cease (for example, whether it might continue to be published on an unrepresentative basis for a further time period ahead of cessation). Another noted reason was that not all sectors are necessarily able to move to alternative benchmarks at the same pace, so despite knowing the benchmark might cease it may not be practicable to restrict all new use at the same time.

3.23 One respondent suggested that the FCA consider a consumer education programme to provide unbiased, authoritative information to ensure that investors understand the impact of any restrictions prior to their occurrence.

3.24 One respondent noted that there is ambiguity in the BMR scope and divergent interpretations of definitions (eg of 'use of a benchmark') and called for further clarity on the scope of the application of any exercise of our new use restriction power. Another called for clarity on how any new use restriction would apply to secondary market activities, which is not 'new use' of a benchmark.

3.25 One respondent said it would be important to ensure international consistency is also applied in relation to any other benchmark which uses the ceasing benchmark as an input (the example provided was USD LIBOR being used as an input to various implied foreign-exchange interest rates).

3.26 In the context of LIBOR, 2 respondents noted that any restriction on new use of USD LIBOR could potentially trigger Type 2 and Type 3 fallbacks in some legacy LIBOR bonds.

Our response

We haven't added any further factors to our Statement of Policy because we think the feedback to this question is already captured by other factors. For example, how engrained a benchmark is in the market could be relevant when assessing whether appropriate alternatives are available; and differences between sectors and asset classes could be relevant when considering both the availability of appropriate alternatives and whether a limited form of restriction would be appropriate.

Similarly, advance notice of the likelihood of the benchmark ceasing is 1 example we provided of something that might help inform the necessary implementation period, but it would not necessarily be the only relevant factor.

It is for firms to satisfy themselves as to whether and how the provisions of the BMR, including a prohibition on use, apply to them, by reference to the legislation and relevant Q&As. If necessary they should seek legal advice. Where there will or may be consequences for customers or investors, firms should be mindful of their obligations under Principle 7 of our principles for businesses: they should engage with customers and investors appropriately to ensure they are made aware of these consequences and of any actions they should or may wish to take in response. With regard to the scope of any restriction on new use, our consultation acknowledged the importance of providing users with clarity on whether they can continue to use the ceasing benchmark in new contracts. We consider that our inclusion within our policy of the factor 'the degree to which we can set out clear and practicable criteria for the market' addresses this adequately.

The new use restriction power can be applied to some or all 'new use' as defined in Article 21A(2) of the BMR. Buying and selling existing financial instruments (ie secondary market activity) does not fall within this definition. However, as set out in our question and answers for firms about conduct risk during LIBOR transition, firms should consider the likely increase in costs of dealing for products linked to a ceasing benchmark as the transition to alternative rate products progresses, and liquidity in the ceasing benchmark products begins to diminish compared with alternatives.

Any restriction on new use of a ceasing benchmark through the exercise of our power under Article 21A would apply to UK supervised entities only. Benchmark administrators that are not UK supervised entities and

rely upon a ceasing benchmark as an input to their benchmarks, would not be in scope of such a restriction. Where a benchmark administrator is a UK supervised entity and uses the ceasing benchmark as an input, it will be a matter for the benchmark administrator to make alternative arrangements.

While we appreciate that contract standardisation may play a role in supporting transition away from critical benchmarks that are being wound down, changes in this area fall within the remit of the contract user and / or relevant trade bodies. Similarly, it is up to counterparties to ensure they understand how our powers on 'use' of critical benchmarks could interact with existing contractual terms.

Q11: ***Please provide any other comments you may have on this consultation.***

3.27 One respondent asked for clarification on how BMR Article 26A relates to supervised third country entities. In their view supervised third country entities are only required to comply with requirements expressly placed on supervised third country entities by the BMR.

3.28 One respondent welcomed further clarification on how the FCA might consider using the 4 month delay on the prohibition of use of an Article 23A benchmark (which is available under Article 23B).

3.29 Some respondents called for early clarity on how we would use our powers for LIBOR, given the timeline to the end of the LIBOR panels. One respondent also suggested the FCA consider further guidance on the treatment of contracts referencing a LIBOR swap rate, rather than LIBOR itself.

Our response

Article 26A makes clear that both supervised entities and supervised third country entities must comply with prohibitions and other requirements imposed on them by the BMR. The applicable prohibitions and requirements will differ according to whether firms are supervised entities or supervised third country entities: it is for firms to satisfy themselves that they understand their obligations under the legislation and if necessary to seek legal advice to this end.

The power at Article 23B(2) of the BMR to delay the prohibition on use of an Article 23A benchmark is separate from our new use restriction powers in relation to other (non-Article 23A) critical benchmarks for which cessation has been announced. We did not consult on our 23B(2) power, as we are not required to publish a Statement of Policy relating to it. Whether or not to exercise it is a matter for the FCA to decide, taking account of the prevailing circumstances at the time. In relation to LIBOR specifically, we have published an Article 23A notice as required by Article 23A(10)(b): this states that the prohibition on use of the six relevant LIBOR settings will take effect on 1 January 2022.

3.30 This Feedback Statement and accompanying Statements of Policy are applicable to all critical benchmarks, including any benchmarks that may be deemed critical in the future. We have published a consultation on our proposed use of both our legacy use power and our new use restriction power in relation to LIBOR specifically. For our new use restriction power, we have already set clear supervisory expectations around stopping new use of USD LIBOR in our March 2021 Dear CEO letter.

3.31 With regard to contracts referencing a LIBOR-based swap rate, there have been several relevant publications to support firms in transitioning away from these benchmarks. For example, industry-led working groups in both the UK and US have developed replacement rates for the GBP and USD LIBOR swap rates, and the International Swaps and Derivatives Association has consulted on fallback provisions to help implement these rates in contracts.

Annex 1
List of non-confidential respondents

Association for Financial Markets in Europe (AFME)

Allen & Overy

Bank of Ireland

BlackRock

Deutsche Bank AG

European Bank for Reconstruction and Development (EBRD)

Financial Markets Law Committee

Financial Services Consumer Panel

Freshfields Bruckhaus Deringer

Investment Company Institute (ICI) Global

International Capital Market Association (ICMA)

International Capital Market Services Association (ICMSA)

Invesco

Investment Association (IA)

International Swaps and Directives Association (ISDA)

Loan Market Association (LMA)

Morgan Stanley

PPP Industry wide response

UK Finance

Annex 2
Abbreviations used in this paper

Abbreviation	Description
BMR	Benchmarks Regulation
FS Act	Financial Services Act 2021
FSMA	Financial Services and Markets Act 2000
GBP	British Pound
Q&A	Question and Answer
USD	United States Dollar

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