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## **ARTICLE 23C BENCHMARKS REGULATION – DRAFT NOTICE OF PERMITTED LEGACY USE BY SUPERVISED ENTITIES**

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### **1. ACTION**

- 1.1. On 3 April 2023, the Authority published a Notice under Article 23A(10)(b) of the Benchmarks Regulation (BMR) setting out its decisions to designate the following benchmarks as Article 23A Benchmarks, effective from 00:01 London time on 1 July 2023:
- A. 1-month US Dollar LIBOR,
  - B. 3-month US Dollar LIBOR, and
  - C. 6-month US Dollar LIBOR.
- together the “**US Dollar LIBOR Versions**”.
- 1.2. These designations taking effect result in supervised entities being prohibited from using the US Dollar LIBOR Versions unless permitted to do so by a notice from the Authority under Article 23C of the BMR.
- 1.3. For the reasons given in this Notice and pursuant to Article 23C(2) of the BMR, the Authority permits all legacy use of the US Dollar LIBOR Versions by supervised entities other than in Cleared Derivatives (whether directly or indirectly cleared) (the “Permitted Use”).
- 1.4. This Notice will take effect on 1 July 2023.

### **2. SUMMARY OF REASONS**

- 2.1. The Authority considers that it is appropriate to permit the Permitted Use under Article 23C(2) of the Benchmarks Regulation, taking into account the Statement of Policy published on 29 September 2021 under Article 23F(1)(c) of the Benchmarks Regulation.
- 2.2. The Authority considers that the expected nature and scale of contracts referencing the US Dollar LIBOR Versions that do not contain adequate provisions to deal with the prohibition under Article 23B is such that not permitting use for such contracts would pose risks to market integrity and consumer protection. Therefore, it is desirable to permit the Permitted Use in order to advance both the Authority’s integrity and consumer protection objectives.
- 2.3. The Authority considers that the Permitted Use should be permitted with effect from 1 July 2023.

### **3. DEFINITIONS**

3.1. The definitions below are used in this Notice:

"2022 Article 23C Notice" means the '[Article 23C Benchmarks Regulation - Notice of Permitted Legacy Use by Supervised Entities](#)' in relation to the Sterling and Yen LIBOR Versions, published by the FCA on 1 January 2022

"the Authority" means the Financial Conduct Authority

"the Benchmarks Regulation" or "BMR" means the UK version of Regulation (EU) No. 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014, which is part of UK law by virtue of the European Union (Withdrawal) Act 2018, as amended by the Financial Services Act 2021 and the Critical Benchmarks (References and Administrators' Liability) Act 2021

"Cleared Derivatives (whether directly or indirectly cleared)" means a derivative which has been cleared through a central counterparty whether or not a direct contractual relationship exists with the central clearing counterparty and whether cleared voluntarily or pursuant to a legal or regulatory obligation

"CP22/21" means the '[Consultation on 'synthetic' US dollar LIBOR and feedback to CP22/11](#)' published by the FCA on 23 November 2022

"IBA" means ICE Benchmark Administration Limited

"ISDA" means the International Swaps and Derivatives Association, Inc.

"ISDA 2020 IBOR Fallbacks Protocol" means the ISDA 2020 IBOR Fallbacks Protocol published on 23 October 2020 by ISDA

"ISDA IBOR Fallbacks Supplement" means the Amendments to the 2006 ISDA Definitions to include new IBOR fallbacks, in supplement number 70 to the 2006 ISDA Definitions, published by ISDA, final on 23 October 2020 and effective on 25 January 2021

"ISDA Derivative" means a derivative to which both the ISDA 2020 IBOR Fallbacks Protocol and the ISDA IBOR Fallbacks Supplement apply

"LIBOR" means the ICE LIBOR benchmark provided by IBA

"RFR" means risk-free rate

"Statement of Policy" means the Statement of Policy relating to the exercise of the Authority's powers under Article 23C published on 29 September 2021 under Article 23F(1)(c) of the BMR

"Sterling and Yen LIBOR Versions" means the 1-month, 3-month and 6-month sterling LIBOR versions; and the 1-month, 3-month and 6-month Japanese yen LIBOR versions

"US' LIBOR Act" means the Adjustable Interest Rate (LIBOR) Act

"version" has the meaning in Article 23G(2) of the BMR and is used to refer to LIBOR as provided for a particular currency and tenor, sometimes known as a LIBOR setting

- 3.2. Words and expressions used in the Benchmarks Regulation have the same meanings where used in this Notice unless the contrary intention appears.

## 4. REASONS

### Background

- 4.1. Article 23A of the UK Benchmarks Regulation grants the Authority the ability, in certain circumstances, to designate a critical benchmark as an Article 23A benchmark, i.e. as being permanently unrepresentative of the market it is intended to measure. This designation results in a prohibition on supervised entities using the benchmark, except where the Authority permits use of the benchmark to continue.
- 4.2. On 3 April 2023, the Authority published a Notice under Article 23A(10)(b) of the Benchmarks Regulation setting out its decisions to designate the US Dollar LIBOR Versions as Article 23A benchmarks with effect from 00:01 London time on 1 July 2023, following the departure of the panel banks that contribute to them currently.
- 4.3. Between 23 November 2022 and 6 January 2023, the Authority consulted on a proposal to exercise the Article 23C power in relation to the US Dollar LIBOR Versions, setting out how it had regard to the Statement of Policy (see [CP22/21](#)). There were 42 total responses to CP22/21, with 39 responses to the questions on the Authority's proposed approach to exercising its legacy use power. Thirty-four respondents agreed with the proposal, 3 were neutral and 1 did not provide a clear response. One respondent claimed to agree with our proposed approach but stated that they could not support permitting use of our proposed synthetic rate for legacy uncleared derivatives. The Authority has taken account of these responses when considering whether and how to exercise its legacy use power and has decided to permit the Permitted Use as set out above.

### Reasons for permitting legacy use by supervised entities

#### Potential risk to consumer protection and market integrity

- 4.4. The Authority's Statement of Policy states that its first consideration is the scale and nature of legacy contracts that do not have adequate provisions to deal with a prohibition on use that follows an Article 23A designation. This group of contracts is comprised of contracts within scope of the BMR that do not contain workable fallbacks or other provisions that are triggered by either permanent unrepresentativeness of the benchmark, material change to the benchmark (where this is either not defined or is defined in a manner that includes permanent unrepresentativeness), or a party to the contract being prohibited from using the benchmark.
- 4.5. In the 2022 Article 23C Notice, the Authority explained that for all the Sterling and Yen LIBOR Versions there was a sufficient number and volume of contracts that were likely not to contain these provisions that it was desirable for the Authority to use its power to permit legacy use in order to advance both consumer protection and market integrity.
- 4.6. The greater scale of usage of the US Dollar LIBOR Versions suggests that contracts referencing these rates are very likely to pose at least the same, and quite probably a considerably greater, risk than any of the Sterling and Yen LIBOR Versions. Therefore, the Authority considers that it should permit legacy use of the US Dollar LIBOR Versions in order to mitigate potential risk to consumer protection and market integrity.

Actual risk to consumer protection and market integrity

- 4.7. Our Statement of Policy explains that the potential risk can be avoided if the contracts described above have been amended to remove reliance on the US Dollar LIBOR Versions before or when the prohibition comes into effect. Therefore, the second consideration is whether and to what degree it is feasible for parties to amend contracts in a way that delivers fair outcomes.
- 4.8. In the 2022 Article 23C Notice, the Authority explained its assessment of the actual risk to consumer protection and market integrity posed by a prohibition on use of the Sterling and Yen LIBOR Versions. The Authority took account of the relevant factors identified in its Statement of Policy in its analysis, including the mechanisms available for, and the likely challenges and obstacles to, transitioning bonds, mortgages, loans and investment funds away from the Sterling and Yen LIBOR Versions to use appropriate alternative rates.

- 4.9. It concluded that while appropriate alternative rates existed, with sufficient use to ensure liquidity and market confidence, most contracts within scope of the BMR (other than cleared derivatives, non-cleared ISDA Derivatives, and most bonds issued after November 2019) had faced barriers to removing their reliance on the Sterling and Yen LIBOR Versions and evidence showed that a significant number of users had not completed all necessary changes to remove reliance on them. Overall, progress on overcoming those barriers was not felt to be sufficient to avoid risks to market integrity and consumer protection if use of the Sterling and Yen LIBOR Versions was not permitted. As a result, the Authority considered that it was desirable to exercise its legacy use power to advance both market integrity and consumer protection.

*Actual risk from contracts referencing the US Dollar LIBOR Versions*

- 4.10. As set out in greater detail in paragraphs 3.48 to 3.71 of CP22/21, the Authority has compared its previous assessment of the risk posed by contracts referencing the Sterling and Yen LIBOR Versions with its knowledge of contracts referencing the US Dollar LIBOR Versions – in order to consider whether there is any reason to conclude that the actual risk arising from the latter group would differ substantially from that identified for the former.
- 4.11. In terms of whether and to what degree it is feasible for parties to amend their contracts, or to otherwise remove reliance on the benchmark, in a way that delivers fair outcomes (taking account of the availability of appropriate alternative rates; the mechanisms for, and the obstacles and challenges to, transitioning away from LIBOR; the likely number and nature of parties to contracts; the effect of prohibition on use; notice of the impending prohibition and experience of transition to date; and linkages between different contracts using the benchmarks – as set out in the Authority’s Statement of Policy), the Authority has identified very few differences between contracts that referenced the Sterling and Yen LIBOR Versions and those that reference the US Dollar LIBOR Versions.
- 4.12. Two differences between these groups of contracts - the existence of LIBOR-related federal legislation in the US (the US’ LIBOR Act) and the prevalence in bonds governed by US law of the requirement for 100% of bondholders to consent to any amendment to contract terms – are not material to the actual risk arising from the US Dollar LIBOR Versions because they only affect contracts governed by US law. Only a very small number of contracts governed by US law are likely to fall within scope of the BMR and thus be impacted by the prohibition under Article 23B.

- 4.13. The key difference identified – the more geographically diverse investor base for contracts referencing the US Dollar LIBOR Versions – increases the complexity and challenge to users of removing their reliance on these benchmarks.
- 4.14. Overall, the Authority’s analysis suggests a high level of similarity between the contracts that referenced the Sterling and Yen LIBOR Versions and those that reference the US Dollar LIBOR Versions. Therefore, the Authority considers it desirable to exercise its legacy use power for these versions to advance both market integrity and consumer protection.

*Further considerations*

- 4.15. The Authority has considered other factors in reaching its decision, in line with its Statement of Policy. As with its approach to actual risks, the Authority has compared its analysis of the Sterling and Yen LIBOR Versions to its knowledge of contracts using the US Dollar LIBOR Versions.

*The effect of permitted legacy use on the robustness and/or the sustainability of any benchmark used as an input to the Article 23A benchmark*

- 4.16. In paragraph 4.21 of the 2022 Article 23C Notice, the Authority explained that it estimated that around 97% of derivatives referencing sterling LIBOR settings were covered by either the ISDA Protocol or clearing house conversion mechanisms. Similar analysis suggests a similar proportion for the US dollar LIBOR derivatives market. This high level of preparedness significantly reduces the risk of any ‘inverted pyramid’ effect (i.e. high use (including indirect use) of a benchmark combined with low levels of activity in the markets underpinning it) on the RFR-based term rates, and any resulting financial stability risk. Therefore, the Authority does not consider that exercising its legacy use power would have any significant adverse effect on the robustness of the CME Term SOFR Reference Rate, a key input into the US dollar LIBOR Versions.

*Whether contracts are required by law or regulation to contain suitable fallback provisions such that they should not be adversely impacted by the prohibition*

- 4.17. Contracts referencing the US Dollar LIBOR Versions that are within scope of the BMR became subject to the requirement to contain fallback clauses that operate in the event of either the cessation of the benchmark or a material change to it at the same time as those referencing the Sterling and Yen LIBOR Versions (1 January 2018). In line with its decision on the Sterling and Yen LIBOR Versions, the Authority has concluded that there is a potential risk of market disruption and a threat to consumer protection if we do not permit these contracts to continue using the US Dollar LIBOR Versions.

*The degree to which we can set out clear and practicable criteria for the market*

- 4.18. The Authority considers that the types of contracts, and the fallback provisions which they contain, that reference the US Dollar LIBOR Versions are similar to those that referenced the Sterling and Yen LIBOR Versions. Consequently, with the exception of Cleared Derivatives (whether directly or indirectly cleared), the Authority does not consider that it can distinguish with clarity and certainty the classes and characteristics of contracts for which permitting legacy use of the US Dollar LIBOR Versions is necessary or desirable, from those for which it is not necessary, in a manner that users would be able to apply to their contracts and determine with confidence and certainty whether they are permitted to use these versions.
- 4.19. For derivatives, all Cleared Derivatives (whether directly or indirectly cleared) should already have moved away from use of the US Dollar LIBOR Versions. So Cleared

Derivatives (whether directly or indirectly cleared) are an identifiable subset of contracts for which permission for legacy use is not necessary.

- 4.20. A small proportion of uncleared derivatives are linked to other contracts or uses of LIBOR in a structural or explicit manner such that risks of transition are lower if they transition to the same alternative rate, at the same time, in order to maintain the economic terms of the transaction. The high level of take-up of the ISDA Protocol in the US dollar derivatives market described at 4.16 above means that most uncleared derivatives are equipped to cope with prohibition and will therefore not move onto the US Dollar LIBOR Versions even if permitted to do so. Therefore, the Authority considers that, as with the Sterling and Yen LIBOR Versions, it would be neither wise nor necessary to undertake the complex task of attempting to delineate this group of contracts from the remainder of uncleared derivatives. The Authority considers that permitting continued legacy use by all uncleared derivatives is the best way to provide clarity and certainty for the market in a timely manner.

*International consistency*

- 4.21. There are particular considerations regarding international consistency for the US Dollar LIBOR Versions that were not relevant to the Authority's decisions on the Sterling and Yen LIBOR Versions. This is because the US has made provision for transitioning contracts referencing the US Dollar LIBOR Versions where they are governed by US law.

*Appropriate alternative rates*

- 4.22. The US' LIBOR Act has the effect of moving legacy contracts that are governed by US law to appropriate alternative rates. It moves most cash products onto the CME Term SOFR Reference Rate plus the relevant ISDA fixed spread adjustment. It moves derivatives to a compounded SOFR rate. As a result, the exercise of the Authority's legacy use power is largely consistent with the US' approach.
- 4.23. The vast majority of uncleared derivatives will transition to SOFR compounded in arrears via the ISDA Protocol, as described at paragraph 4.16 above. However, as noted in paragraph 4.20, the Authority has identified a small proportion of derivatives that are linked to other contracts or uses of LIBOR in a structural or explicit manner such that risks of transition are lower if they transition to the same alternative rate, at the same time, in order to maintain the economic terms of the transaction. As set out at paragraph 4.20, given the complexity of attempting to delineate this subset of uncleared derivatives, the Authority considers that permitting legacy use by all uncleared derivatives is the best way to provide clarity and certainty for the market in a timely manner.

*Contracts governed by US law with workable cessation fallbacks*

- 4.24. As described in further detail in paragraphs 3.59 to 3.66 of CP22/21, the Authority has considered the interaction between the US' LIBOR Act and the Authority's exercise of its legacy use power.
- 4.25. The only contracts governed by US law that may potentially use the US Dollar LIBOR Versions after the end of the US dollar LIBOR panel are those with workable non-LIBOR fallback provisions that are triggered by the US Dollar LIBOR Versions' cessation. These contracts do not fall within scope of the US' LIBOR Act, which leaves them to operate as drafted. Therefore, there will be no direct legal conflict between the operation of the US' LIBOR Act and the Authority's exercise of its legacy use power.
- 4.26. The Authority's only mechanism to prevent legacy use of the US Dollar LIBOR Versions by contracts governed by US law that are not covered by the US' LIBOR Act would be to not permit legacy use of the US Dollar LIBOR Versions by any contracts that are governed by

US law. However, only a very small subset of contracts governed by US law is likely to fall within the scope of the BMR and thus be impacted by such a prohibition. Therefore, parties to the affected US law contracts would have to ascertain whether their contract is within scope of the BMR in order to know whether their contract was permitted to use the US Dollar LIBOR Versions. As a result, the Authority considers that such a restriction would increase complexity for the market, as well posing a risk that some contracts could face legal uncertainty and the potential for litigation.

*Time limited permission and/or conditionality*

- 4.27. The Authority has considered whether it would be appropriate to apply limitations or conditionality to the permission of legacy use.
- 4.28. The Authority has indicated that it intends to compel publication of the US Dollar LIBOR Versions beyond end-June 2023, with the expectation that (subject to further reviews as required by Article 21(3) of the BMR) they will continue to be published until end-September 2024 (15 months after the US dollar LIBOR panel ceases) but not beyond that date. As the US Dollar LIBOR Versions are expected to be published only for this short period, the Authority considers that there would likely be limited value in setting time limitations or conditions on its permitted legacy use and therefore has decided not to do so at this time.

**Effects of the permitted legacy use by supervised entities**

- 4.29. Supervised entities are permitted to continue to use the US Dollar LIBOR Versions other than in Cleared Derivatives (whether directly or indirectly cleared) unless and until a further Notice is published in accordance with Article 23C(2) of the BMR altering or withdrawing this permission.
- 4.30. Supervised entities who are permitted to continue to use the US Dollar LIBOR Versions should note that any exercise of the Authority's powers under Article 23D of the Benchmarks Regulation would also be relevant to such continued use.

**5. PROCEDURAL MATTERS**

- 5.1. This Notice is given under Article 23C(2) of the Benchmarks Regulation. It is published in accordance with Article 23C(8) of the Benchmarks Regulation.
- 5.2. A copy of this Notice has been given to the Treasury pursuant to Article 23C(9)(a) of the Benchmarks Regulation.

**FCA contacts**

- 5.3. For more information concerning this matter generally, contact [benchmarkspolicy@fca.org.uk](mailto:benchmarkspolicy@fca.org.uk).

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