

Investment Company Institute response to the Financial Conduct Authority consultation on Article 23A of the UK Benchmarks Regulation

The Investment Company Institute, including ICI Global,¹ appreciates the opportunity to provide its response to the Financial Conduct Authority (FCA) consultation on the proposed policy with respect to its exercise of powers under new Article 23A of the UK Benchmarks Regulation (UK BMR).² New Article 23A, if adopted, would permit the FCA to designate a critical benchmark as an Article 23A benchmark, thereby triggering further powers to restrict use of the benchmark or impose other requirements.

As the trade association representing regulated funds globally,³ ICI has a significant interest in the orderly transition from LIBOR benchmarks. We reviewed new Article 23A with a view to its potential impact on and interaction with, among other concerns:

- The identification and adoption by the relevant market of appropriate fallback language and replacement benchmark rates;
- Derivatives contracts covered by the ISDA 2020 IBOR Fallbacks Protocol; and
- The availability and adequacy of market, regulatory, or legislative solutions for dealing with tough legacy contracts.⁴

¹ The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US\$27.7 trillion in the United States, serving more than 100 million US shareholders, and US\$8.3 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

² See Consultation on proposed policy with respect to the designation of benchmarks under new Article 23A (November 2020), *available at* <https://www.fca.org.uk/publication/policy/consultation-designation-benchmarks-new-article-23a.pdf>. ICI notes that this response to the consultation should be read in conjunction with its response to the concurrent FCA consultation on proposed new Article 23D.

³ The term "regulated funds" includes US funds, which are comprehensively regulated under the Investment Company Act of 1940 (Investment Company Act), and non-US funds, that are organized or formed outside the US and substantively regulated to make them eligible for sale to retail investors, such as funds domiciled in the European Union and qualified under the UCITS Directive (EU Directive 2009/65/EC, as amended), Canadian investment funds subject to National Instrument 81-102, and investment funds subject to the Hong Kong Code on Unit Trusts and Mutual Funds.

⁴ For the purposes of this submission, "tough legacy" contracts are contracts referencing a LIBOR currency/tenor pairing referencing a discontinued or non-representative benchmark and that are still in force at the date of cessation of the benchmark.

ICI's overall priorities in evaluating proposals for benchmark transition are:

- To support proposals that provide legal certainty to market participants and minimize changes to the economic value of affected contracts;
- To promote global alignment on benchmark reform to reduce potential friction and differences in regulatory or legislative approaches to transition; and
- To promote transparency with respect to the policies developed by the FCA about the manner in which it would exercise its powers under the UK BMR.

Given those overall priorities, ICI recommends that the FCA engage with global policymakers and market participants to ensure its proposed use of its powers under the UK BMR align with the approaches being taken in other jurisdictions. Further, we recommend that the FCA continue to provide notice and guidance to the market on its use of its powers under the UK BMR and other benchmark transition developments. We discuss these recommendations as well as our responses to specific consultation questions in further detail below.

Global Alignment

LIBORs are global interest rate benchmarks and, as a result, transition from one to another is a complex process involving numerous legal jurisdictions, regulatory regimes, and regulators. Avoiding material differences, overlaps, or gaps in coverage among the approaches to benchmark transition across the globe would minimize the risk of litigation, accelerate the progress of market participants' operational readiness, and reduce the opportunity for regulatory arbitrage or adverse market impacts.

ICI recommends that the FCA consider the potential consequences of making an Article 23A designation with respect to a LIBOR currency/tenor pairing both within and outside the UK. We recommend that the FCA seek and act on input from other global regulators, central banks, and private sector risk-free working groups to align approaches to the extent possible. We particularly recommend alignment in approaches determining which contracts will be permitted to use a replacement or "synthetically" calculated rate, when fallback language would be triggered by announcements of cessation or non-representativeness, and how to align replacement or synthetically calculated rates covering the same LIBOR currency/tenor pairing across jurisdictions. We recognize that such alignment may be challenging given the nascent stage of wind-down in several LIBOR currency jurisdictions and recommend that the FCA be mindful of the timing of acting on its expected powers.

Market Guidance

To further promote LIBOR transition, the FCA should provide a potential timeline or decision tree regarding its likely outcomes and next steps following the enactment of the UK BMR. Such a timeline would be useful for market participants to understand the anticipated interplay of the FCA's use of its powers with other global consultation processes, such as the ICE Benchmark Administrator's proposed cessation of the publication of LIBOR currency/tenor pairings and the

new powers to be granted pursuant to the amendments proposed to be made to the EU Benchmarks Regulation.⁵

ICI also recommends that the FCA consider providing tailored guidance for asset managers and buy-side firms. While this part of the industry has been monitoring and moving forward with their LIBOR transition programs, it would be helpful to understand regulators' current expectations for the steps and timeframes for transition programs as LIBOR cessation dates approach.

Regarding the FCA's expected powers under Article 23A in particular, the FCA should clearly identify any designation announcements that are being made in the awareness that they will engage contractual triggers, such as those in the ISDA Protocol and Supplement.⁶

Question 1: Do you agree with the factors that we plan to consider when determining whether we can designate a benchmark as an Article 23A benchmark?

ICI broadly agrees with the factors that the consultation indicates the FCA will consider in determining whether it *can* designate a benchmark as an Article 23A benchmark. We also note that these factors may be relevant to a determination by the FCA that it *should* designate a benchmark as an Article 23A benchmark (Question 2 below).

To provide more clarity and transparency regarding the relevant factors, however, we recommend that the FCA first provide its policy (under new Article 23C) for permitting legacy use of a relevant benchmark before assessing the impact of the designation of a critical benchmark on the market. Further, the FCA should work with global policymakers and market participants to provide guidance clarifying the effect of designation on use of a benchmark by third-country entities that are not supervised by the FCA.

Any designation of a LIBOR benchmark should be dependent upon the progress made on reducing the number of affected LIBOR-linked contracts as much as possible, and on the acceptance by relevant markets of appropriate fallback provisions, replacement rates and spread adjustments. We urge that any policy with respect to the FCA's use of the projected Article 23C or Article 23D powers should be announced to the market well in advance of any designation being made with respect to any LIBOR currency/tenor pairing so that any related planning and analysis can be done with as much certainty around the consequences of the exercise of these powers as is possible.

⁵ Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 as amended, *available at* <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02016R1011-20191210&from=EN>. We note there is a risk of a conflict of law given the purported right under the amended EU BMR to impose a statutory replacement rate on certain contracts to which only parties established in an EU member state are a party, notwithstanding that the governing law of those contracts is not the law of an EU member state.

⁶ *See* Amendments to the 2006 ISDA Definitions to include new IBOR fallbacks (Oct. 23, 2020), *available at* http://assets.isda.org/media/3062e7b4/23aa1658-pdf/?_zs=rHJ4P1&_zl=EEa16; and ISDA 2020 IBOR Fallbacks Protocol, *available at* http://assets.isda.org/media/3062e7b4/08268161-pdf/?_zs=rHJ4P1&_zl=FEa16.

Question 2: Do you agree with the factors that we plan to consider when determining whether we should designate a benchmark as an Article 23A benchmark?

See response above.

Question 3: Do you think there are any additional factors we should take into account?

ICI notes that new Article 23B provides for a period of up to four months between designation of a critical benchmark under Article 23A and the imposition of a prohibition on use (as defined in Article 3(7) of the UK BMR) of that critical benchmark by UK supervised entities. ICI recommends that the FCA articulate its policy (or make an assessment at the time of designation) on the length of the period between the date of designation and the date of the prohibition on use. ICI would welcome clarity around how the FCA will gauge the impact of the automatic prohibition following designation on financial instruments linked to popular LIBOR currency/pairings, taking into account any possible dislocation in markets and pricing of these instruments if UK supervised entities are prohibited from using these benchmarks.