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FCA to Be Granted Enhanced Powers to Ensure Orderly Wind-down of Libor Contracts

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On June 23, 2020, the U.K. Government announced plans to issue a Financial Services Bill that will enhance the regulatory powers of the Financial Conduct Authority ("FCA") to help manage and direct an orderly wind-down period prior to Libor's eventual cessation by the end of 2021 in a manner that protects consumers and ensures market integrity.[1] The FCA's enhanced powers will include the power to direct the Libor administrator to change the methodology used to compile Libor specifically for "tough legacy" contracts (that is, contracts that genuinely have no or inappropriate alternatives to Libor and no realistic ability to be renegotiated or amended).

Also on June 23, the FCA published a statement welcoming the U.K. Government's announcement,[2] as well as a publication providing more information on the proposed legislation.[3] Importantly, the legislation does not mean that Libor's methodology will be changed; rather, it will make it possible to require such a change in specific circumstances to promote an orderly wind-down. In exercising its power to require modifications of the methodology in determining Libor under the new legislation, the FCA will seek market feedback on viable methodology changes that would reduce the risk of published Libor values diverging from the values of the fallbacks that have emerged internationally and in the U.K. using risk-free rates ("RFRs") (e.g., the Secured Overnight Financing Rate as the alternative for USD Libor), adjusted for the relevant term of the contract, and with a fixed credit spread adjustment added.

The U.K. Government and the FCA have both emphasized that, for contracts that do not fall within the narrow pool of "tough legacy" contracts, market participants should continue to actively transition away from Libor by mutual agreement wherever possible through conversion of the benchmark in the contract or insertion of sufficiently robust fallbacks. The FCA further warned that, even if regulatory action to change the methodology enabled by the planned legislation is feasible, parties relying on such action will not have control over its economic terms, and any such change may not precisely replicate the market's prevailing preferred structures based on RFRs. Scott O'Malia, ISDA's Chief Executive Officer, also emphasized that the U.K.'s proposed legislation will not impact ISDA's work on developing new fallbacks for derivatives that reference interbank offered rates, and the timing and content for publishing the 2006 ISDA Definitions and a protocol to incorporate those fallbacks into new and legacy derivatives remain unchanged.[4]

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[1] "Financial Services Regulation: Written statement – HCWS307," available here.

[2] "FCA statement on planned amendments to the Benchmarks Regulation," available here.

[3] "Benchmarks Regulation – proposed new powers," available here.

[4] "Tackling Tough Legacy," available here.

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