Benchmarks Regulation and proposed amendments under the Financial Services Bill

November 2020

This document provides background to the Benchmarks Regulation and amendments proposed by the Government under the Financial Services Bill (FS Bill) to give us enhanced powers, in particular in relation to managing the orderly wind-down of critical benchmarks. As is widely known, these powers have been introduced at the present time in order to allow us to properly address the issues relating to LIBOR transition.

We set out below the details of those powers as provided in the Bill and provide links to relevant consultations about our proposed polices in respect of those powers. We will update this document over time to reflect new consultations, the parliamentary process, market changes and publications of Statements of Policy.

1. Benchmarks Regulation

1.1 Benchmarks are used in a wide range of markets to help set prices, measure performance, or work out amounts payable under financial contracts. They are integral to the functioning of financial markets.

1.2 In 2013, the International Organisation of Securities Commissions (IOSCO) published its overarching framework of Principles for Financial Benchmarks, in particular, to address conflicts of interest in the benchmark-setting process. This provided the foundations for the EU Benchmarks Regulation (BMR) which took full effect on 1 January 2018.

1.3 The EU BMR places requirements on benchmark administrators and contributors, and supervised entities which use benchmarks, to ensure that benchmarks are robust and reliable. It replaced the previous UK regulatory regime that regulated eight benchmarks specified by HM Treasury. At the end of the EU Withdrawal Transition Period, the amended EU BMR will form part of retained EU law and will continue to apply in the UK.

1.4 Under the BMR, we are responsible for the authorisation and registration of UK benchmark administrators as well as the supervision of administrators, contributors and supervised entities which are users in the UK.

1.5 The BMR defines 'critical benchmarks' and imposes additional regulatory requirements on the administrators of, and contributors to, these benchmarks. LIBOR is a critical benchmark under the BMR.

1.6 Under Article 21(3) of the BMR, we can require the administrator of a critical benchmark to continue publishing a critical benchmark that it otherwise intends to cease, until such time as:

- the provision of the benchmark has been transitioned to a new administrator;

- the benchmark can be ceased to be provided in an orderly fashion; or
- the benchmark is no longer critical.

1.7 Where we use the Article 21(3) power, we are required to review the exercise of this power annually. Under the current BMR, the maximum period of mandatory administration shall not exceed five years in total. The FS Bill has proposed to extend this to ten years, along with other changes detailed below.

1.8 Under Article 23(6), we can require supervised contributors, including entities that are not yet contributors to the relevant critical benchmark, to contribute input data, if we consider that the representativeness of the benchmark is put at risk by the departure of a contributor, to maintain the representativeness of a critical benchmark of the underlying market or economic reality that the benchmark is intended to measure. A contributor is required under Article 23(3) promptly to notify the administrator if it intends to stop contributing input data to a critical benchmark. We are required to review our exercise of the Article 23(6) power annually. The maximum period of mandatory contribution shall not exceed five years in total.

1.9 A benchmark administrator is otherwise obliged under Article 11(4) to cease the provision of an unrepresentative critical benchmark within a reasonable time period, if representativeness cannot be restored or maintained.

2. LIBOR transition

2.1 LIBOR is the only existing critical benchmark whose administrator is regulated by the FCA. In 2014, the Financial Stability Board recommended transition away from certain major interest rate benchmarks generally known as IBORs or Interbank Offered Rates, including LIBOR, to alternative risk-free rates. This is because the underlying markets that IBORs intend to measure are no longer sufficiently active and panel banks which contribute input data to IBORs are increasingly reliant on 'expert judgement' for submissions.

2.2 In November 2017, we announced that the LIBOR panel banks had agreed to support the LIBOR benchmark until end-2021. We also said publicly in July 2017 that it may not be possible for the administrator to produce LIBOR after end-2021 if the panel banks are unwilling to continue to contribute to the rate. In the same speech in July 2017, we stated our intention that "at the end of this period, it would no longer be necessary for us to persuade, or compel, banks to submit to LIBOR".

2.3 Accordingly, we do not expect LIBOR to cease or become non-representative before end-2021 as LIBOR panel banks have confirmed to us that they will remain on the LIBOR panels until end-2021.

2.4 We published a statement on 18th November acknowledging the intention of the LIBOR administrator (IBA) to consult the market on the future of LIBOR after end-2021. Markets need to be prepared for potential announcements from IBA and us, following and subject to decisions that could be taken following completion of IBA's consultation, that various LIBOR settings will cease, or could no longer be published in a way that is representative of their underlying market or economic reality, from end-2021. IBA has a policy of giving market participants at least one year's notice of an intention to cease publishing any LIBOR settings.

2.5 Where parties to contracts referencing LIBOR cannot reach agreement on how those contracts would operate in the event of LIBOR's cessation, discontinuation could cause uncertainty, litigation or loss of value because contracts no longer function as intended. If this problem affects large volumes of contract it could pose risks to wider market integrity.

2.6 We, alongside the Bank of England and other regulators internationally, have been encouraging an industry-led transition away from LIBOR, primarily through the use of alternative benchmarks, so-called "Risk Free Rates". The Sterling Risk Free Rate Working Group (RFRWG) has been working with the Bank of England and us to catalyse a broad-based transition to SONIA, the RFR for sterling LIBOR, by end-2021. There are similar working groups in other LIBOR currency jurisdictions. We have also been encouraging adoption of robust fallbacks into all new and, where possible, legacy contracts so they continue to operate if and when LIBOR ceases.

2.7 However, we expect that there will be a pool of contracts, identified by the RFRWG as "tough legacy", that have no realistic prospect of being amended to transition away from LIBOR by end-2021. This may be the case for sterling, as well as potentially for other LIBOR currencies. These contracts might not function as intended if there were a sudden cessation of LIBOR. This could lead to disruption that is incompatible with our operational objectives of ensuring an appropriate degree of protection for consumers and protecting and enhancing the integrity of the UK financial system.

2.8 Without the amendments proposed in the FS Bill, however, the BMR gives the FCA limited ability to manage the 'wind-down' of a critical benchmark, such as LIBOR prior to an eventual cessation, in order to help certain legacy contracts that cannot realistically transition.

3. Proposed amendments to the BMR under the Financial Services Bill

3.1 To help ensure an orderly wind-down of a critical benchmark, such as LIBOR, the Government has proposed legislation as part of the FS Bill to amend and enhance our powers under the BMR. The FS Bill has been introduced into Parliament and is now subject to debate and consideration before it may be enacted.

3.2 The proposed legislation will allow us to require the administrator of a critical benchmark to change how a benchmark is determined, rules of the benchmark and code of conduct (if the benchmark is based on submissions from contributors). These powers would allow us to direct a change of methodology of a critical benchmark, such as LIBOR, so that it is no longer reliant on panel bank contributions, in order to wind it down on an orderly basis before its eventual cessation. We may only exercise this power if we consider it appropriate to do so having regard to the desirability of securing that the cessation of the benchmark takes place in an orderly way and it is desirable to advance either or both of our objectives of ensuring an appropriate degree of protection for consumers and protecting and enhancing the integrity of the UK financial system.

3.3 Under the BMR and the proposed amendments, we are required to conduct, under a range of circumstances, an assessment of whether a critical benchmark is representative of the underlying market or economic reality it is intended to measure, or that its representativeness is at risk. These circumstances would include when the administrator gives its cessation notice to us and we decide to require it to continue publishing the benchmark or when a contributor gives its notice to the administrator to cease contributing input data.

3.4 Following our assessments, we will have the option to 'designate' a critical benchmark under conditions specified in the BMR as proposed to be amended by the FS Bill. We will be able to 'designate' a benchmark, such as LIBOR, as an 'Article 23A benchmark' (see details below) if its representativeness cannot reasonably be restored or maintained, or if the representativeness can be restored or maintained but there are not good reasons to do so.

3.5 Subject to Parliamentary approval of the Bill, following any designation of a benchmark as an Article 23A benchmark, we will then have access to a range of new, enhanced powers, as described below in section 4.

4. Decision-making under the Financial Services Bill

4.1 We describe below our key decision-making process that could unfold following a range of circumstances. These circumstances include the

receipt of a cessation notice from the administrator of a critical benchmark, and/or where contributors have notified the administrator of their intention to cease contributing input data to the benchmark. This is based on the current BMR and proposed amendments in the FS Bill. The exact path of our decisions would depend on the events and the sequence in which they occur, and the final FS Bill provisions approved by the Parliament.

4.2 Further, the FS Bill also provides for HM Treasury or the Secretary of State to make, by regulations, transitional, transitory or saving provisions in order to provide continuity with respect to decisions made or powers exercised by us in accordance with the BMR before the proposed legislation is commenced. This is to cater for the plausible scenario where either the administrator of a critical benchmark informs us of its intention to cease publication, or where contributors have notified the administrator of their intention to cease contributing input data to the benchmark before the relevant proposed provisions in the Bill are enacted and commenced.

Assessment of representativeness of critical benchmarks by us under proposed amendments to Article 21

Article 21

4.3 Under the existing Article 21(1), the administrator of a critical benchmark that intends to cease providing that benchmark is required to give us notice and submit to us an assessment of how the benchmark is to be ceased. Upon receiving the administrator's assessment, we are required to make our own assessment of the administrator's plan (under the existing Article 21(2)). If we decide to compel the administrator to continue publication (under the existing Article 21(3)) after having completed our own assessment, we are required under the proposed Article 21(3A) to conduct an assessment of the capability of the benchmark to measure the underlying market or economic reality.

4.4 We will be required by the proposed Article 21(3B) and Article 21(3C) to conduct our assessment within a limited time period and to issue a notice to the administrator on the outcomes of our assessment under Article 21(3A), stating:

- that we consider that the benchmark is not representative of the market or economic reality that it is intended to measure or that the representativeness of the benchmark is at risk, or
- that we consider that the representativeness of the benchmark is not at risk.

Prohibition on new use where administrator to cease providing critical benchmark

Proposed Article 21A

4.5 Following our assessment under Article 21(2) of the administrator's cessation plan, we will have the power under the proposed Article 21A to prohibit some or all new use of the benchmark by publishing a notice. 'New use of a benchmark' is set out under Article 21A(2).

4.6 We may only exercise this power if we consider it desirable to advance either or both of our objectives of ensuring an appropriate degree of protection for consumers and protecting and enhancing the integrity of the UK financial system. We will also be able to consider the effect of the exercise of this power outside the UK.

4.7 Before exercising our power under Article 21A, we will be required under proposed Article 23F to publish a Statement of Policy and we must have regard to it in exercising the power.

Assessment of representativeness of critical benchmarks by us under proposed Article 22A and Article 22B

Proposed Article 22A

4.8 Article 22A requires the administrator of a critical benchmark which is based on submissions by contributors the majority of which are supervised entities or supervised third country entities (and which is not an Article 23A benchmark as described below), to conduct an assessment of the capability of the benchmark to measure the underlying market or economic reality it is intended to measure:

- biennially,
- subject to our written notice, where we have concerns with the representativeness of the benchmark, or
- where a supervised contributor gives notice of its intention to cease contributing input data

4.9 If a contributor gives notice to cease contribution, the administrator will need to submit its assessment to us within 14 days after the contributor notifies the administrator of its intention to cease contribution. Under the BMR as proposed to be amended by the FS Bill, the period between a contributor providing notice and ceasing to contribute input data must be no less than 15 weeks.

Proposed Article 22B

4.10 Following receipt of the administrator's assessment as provided under Article 22A, we will be required under Article 22B to conduct our own assessment of the capability of the benchmark to measure the underlying market or economic reality.

4.11 We will be required to issue a written notice to the administrator on the outcome of our assessment, stating:
- that we consider that the benchmark is not representative of the market or economic reality that it is intended to measure or that the representativeness of the benchmark is at risk, or
- that we consider that the representativeness of the benchmark is not at risk.

4.12 In circumstances where a supervised contributor gives notice of its intention to cease contributing input data to the administrator, we must complete our assessment, and issue a notice to the administrator stating the outcome of our assessment within 28 days after the administrator was notified of the contributor's departure.

To restore the representativeness of a critical benchmark

Article 23

4.13 The existing Article 23(6) allows us to restore the representativeness of a critical benchmark, if following our assessments (under Article 21, proposed Article 22A or Article 22B), we consider that the benchmark is no longer representative or its representativeness is at risk but it is appropriate to maintain, restore or improve its representativeness.

4.14 We can use our Article 23(6) power to compel contribution from supervised entities, including those entities who are not currently contributors to the benchmark, but only for a maximum period of 5 years. We can also require the administrator to change the methodology, code of conduct or other rules of the benchmark.

Designation of a critical benchmark

Proposed Article 23A

4.15 Following our giving the administrator of a critical benchmark a written notice under Article 21(3B)(a) or Article 22B(3)(a) (benchmark unrepresentative or representativeness at risk) we will have the power to designate the benchmark as an Article 23A benchmark unless we consider that it is, and is likely to continue to be, the case that:
- The representativeness of the benchmark can reasonably be restored and maintained either by the administrator or by our exercising our Article 23(6) powers, and

- There are good reasons to restore and maintain its representativeness.

  To make a final designation decision, we will be required to engage with the administrator through a process prescribed by the proposed legislation. The process will also require us to publish a notice stating when the designation of the benchmark takes effect, which may be at a future date and after the decision to designate.

4.16 We will also be required under proposed Article 23F to publish a Statement of Policy before exercising the power to designate a benchmark as an Article 23A benchmark and we must have regard to it in exercising the power. Our consultation about our proposed policy in respect of the designation of benchmarks under Article 23A is here.

Prohibition on use and exemption for legacy use of Article 23A benchmark

Proposed Article 23B

4.17 Article 23B provides that all use by supervised entities of an Article 23A designated benchmark is prohibited when the Article 23A designation takes effect, except where we make exemptions under Article 23C. We may, by issuing a public notice, delay the prohibition for up to four months beginning with the day on which the Article 23A designation takes effect. Our expectation is that the prohibition would only take effect when the benchmark becomes unrepresentative, for example, upon the withdrawal of panel banks.

Proposed Article 23C

4.18 We will have the power under Article 23C to permit some or all legacy use by supervised entities of an Article 23A designated benchmark. We may alter or withdraw the permission by issuing a notice. We may only exercise any of those powers if we consider it desirable to advance either or both of our objectives of securing an appropriate degree of protection for consumers and protecting and enhancing the integrity of the UK financial system.

4.19 We will be required under proposed Article 23F to publish a Statement of Policy before exercising our Article 23C power and we must have regard to it in exercising the power.

Orderly cessation of Article 23A benchmark

Proposed Article 23D

4.20 Once we designate a critical benchmark as an Article 23A benchmark, under Article 23D we may require changes to: the way in which the benchmark is determined, including its input data; rules of the benchmark; and, where the benchmark is based on submissions by contributors, the code of conduct. We will only be able to exercise this power if we consider it appropriate to do so having regard to the desirability of securing that the cessation of the benchmark takes place in an orderly fashion, and if we consider it is desirable to advance either or both of our objectives of securing an appropriate degree of protection for consumers and protecting and enhancing the integrity of the UK financial system.

4.21 Before exercising this power, we will be required under proposed Article 23F to publish a Statement of Policy and we must have regard to it in exercising the power. Our consultation about our proposed policy in respect of our powers under Article 23D is here.

4.22 Proposed Article 23D(11) also provides that once a benchmark is designated as an Article 23A benchmark, the BMR will apply to the benchmark with modifications as set out in proposed Annex 4. This is because, for example, rules around input data under Article 11(1) might no longer be applicable to an Article 23A benchmark.

5. Statements of Policy

5.1 We will be required by the BMR as proposed to be amended by the FS Bill to publish Statements of Policy before exercising certain powers and we must have regard to them when exercising those powers (under proposed Article 23F). These are in relation to:

- The exercise of our power under proposed Article 21A;
- The designation of benchmarks under proposed Article 23A;
- The exercise of our power under proposed Article 23C; and
- The exercise of our powers under proposed Article 23D.

5.2 The FS Bill provides that we may prepare and publish statements of policy before the Bill is enacted. We said in June that we will engage the market on developing relevant policies.

5.3 Although we are not required by the FS Bill amendments to the BMR to consult, we have now published consultations on our policy intentions for exercising our powers under the proposed Article 23A and Article 23D. We plan to consult publicly in Q2 2021 on our policy intentions for exercising our powers under the proposed Article 21A and Article 23C.

5.4 Following these consultations, we will take account of responses and publish the relevant Statements of Policy on our website.

5.5 We will conduct a further consultation in due course on any future decision to use our powers under proposed Article 23D in relation to LIBOR.