Critical Benchmarks (References and Administrators' Liability) Bill [HL]

HL Bill 49 of 2021–22

Author: Chris Smith

Date published: 1 October 2021

On 13 October 2021, the House of Lords is scheduled to debate the second reading of the Critical Benchmarks (References and Administrators' Liability) Bill.

The aim of the bill is to reduce the scope for uncertainty and litigation arising from the withdrawal of a key interest rate which is used as a 'benchmark' in the UK financial system.

Benchmarks are indices used to work out amounts payable in contracts (usually financial ones). A 'critical benchmark' is one that is considered particularly important because of its wide use. In the UK, the only critical benchmark is the London interbank offer rate (LIBOR).

The Bank of England has stated that the calculations underlying LIBOR are increasingly unreliable, creating a systemic risk to the UK economy. Therefore, it has been working with other regulators and market participants to transition away from LIBOR. However, some contracts will face significant barriers to moving away from LIBOR. These are known as 'tough legacy' contracts.

The Financial Services Act 2021 amended the regulations governing benchmarks to deal with the wind-down of a critical benchmark and to manage tough legacy contracts. The changes granted the Financial Conduct Authority (FCA) certain powers, such as prohibiting new contracts from using the benchmark and prescribing how the index calculation is made.

The bill's provisions would add further measures to the benchmark regulations that are intended to:

- provide greater legal certainty that tough legacy contracts can continue to operate using the designated benchmark; and
- grant the administrator of the designated benchmark immunity from legal action where it takes actions because of requirements imposed by the regulator.

The Government states that reducing legal disputes related to the wind-down of LIBOR should result in lower costs for firms and lessen the risk that disputes undermine an orderly wind-down, which could in turn impact the stability of the UK financial system.

Some commentators have suggested that the provisions do not go far enough in reducing the potential for litigation. Instead, they have called for a more general 'safe harbour' provision against claims. It has also been argued that the definition of a tough legacy contract will be important as it will determine the range of contracts for which the bill provides continuity. The FCA has recently published a policy statement on how it will use its powers in this area.

1. Overview of the bill

The Critical Benchmarks (References and Administrators' Liability) Bill [HL] is a government bill introduced into the House of Lords on 8 September 2021. It is due to have its second reading on 13 October 2021.

The bill is intended to support the orderly wind-down of an important financial services benchmark, such as the London interbank offer rate (LIBOR). It contains measures in two areas:

- Providing greater legal certainty that contracts facing barriers to moving away from a benchmark that is being wound down, such as LIBOR, can continue to operate using the benchmark.
- Granting the administrator of the benchmark that is being wound down immunity from legal action where it takes actions as a result of requirements imposed by the regulator, the Financial Conduct Authority (FCA).

2. Policy background

2.1 Benchmarks

In financial services, 'benchmarks' are indices used to set prices, measure performance and work out amounts payable under contracts such as derivatives, bonds and loans.[1]

A 'critical benchmark' is one that is considered particularly important. A benchmark will be deemed critical if, for example, it is used in contracts with a total value of at least €500 billion.[2]

2.2 LIBOR

LIBOR is a series of interest rates that measure the cost at which banks can borrow from the wholesale lending market. It is widely used as a benchmark and is considered systemically important.[3] The Government estimated that, in April 2021, LIBOR rates underpinned contracts worth around $300 trillion.[4] Hence, it is a critical benchmark in the UK and is the only benchmark so classified.[5]

LIBOR is calculated for seven time periods and in five different currencies, giving a total of 35 versions. Each version is published daily.[6]

---

[1] Explanatory Notes, p 2. Benchmarks may also be used in some non-financial contexts; for example, leases.

[2] Regulation (EU) 2016/1011 of the European Parliament and of the Council, UK version as amended, article 20 paragraph 1. The figure is denominated in euros because it originates from EU law.

[3] Explanatory Notes, p 2; and Working Group on Sterling Risk-Free Reference Rates, *Preparing for 2022: What You Need to Know About LIBOR Transition*, November 2018, p 3.

[4] Explanatory Notes, p 2. This amount has reduced from an estimated $400 trillion in August 2020: Bank of England, *Financial Stability Report*, August 2020, p 85.

[5] Explanatory Notes, p 2. LIBOR was removed from the list of critical benchmarks in the EU on 9 July 2021 because the EU's requirements include that the benchmark administrator must be located in the EU: Simon Lovegrove, 'Additions and removals to the list of critical benchmarks under the benchmarks regulation', Norton Rose Fulbright, 12 July 2021.

[6] Explanatory Notes, p 2.

2.3 Issues with LIBOR

Issues with LIBOR date back to 2009, when international financial regulators began investigating some financial institutions for alleged misconduct relating to it and other benchmarks.[7] Ultimately, this led the UK Government to make the administration of LIBOR, and contributing data to its calculations, regulated activities through the Financial Services Act 2012.

More recently, there have been concerns that the underlying markets that these rates intend to measure are no longer sufficiently active to provide accurate data. Hence, the Bank of England has stated that "continued use is no longer a sustainable model".[8] In particular, the Bank says that LIBOR calculations increasingly rely on "expert judgments" from banks. In 2014, the Financial Stability Board, the international body that monitors the financial system, said this represents a "potentially serious" source of systemic risk.[9] It recommended a move away from LIBOR to alternative risk-free and "nearly risk-free" rates.

2.4 Winding down LIBOR

In 2015, market participants formed a working group to support and advise on the transition away from LIBOR.[10] In 2017, it recommended an alternative rate for sterling markets, the sterling overnight index average (SONIA). From 2018, the financial regulators (the Bank of England, FCA and the Prudential Regulatory Authority), alongside the working group, have been encouraging market participants to plan for the transition from LIBOR to SONIA.[11]

However, the Government has stated that some contracts will "face significant barriers to moving off LIBOR".[12] These are known as 'tough legacy' contracts.

In March 2021, the FCA set out its expectation that production of the majority of LIBOR rates would end immediately after 31 December 2021 and the remainder by 1 July 2023.[13] Without further action, this could have left parties to tough legacy contracts with no means of determining payments under them. The Bank of England said this would give rise to risks to financial stability.[14]

In response, the Government has provided legislative support to the wind-down of LIBOR. The Financial Services Act 2021 contained some measures, and this bill contains further ones.[15] These are described below in the context of the overall legislative framework for benchmarks, set out in the next section of this briefing.

---

[7] Explanatory Notes, p 8.

[8] ibid.

[9] Financial Stability Board, *Reforming Major Interest Rate Benchmarks*, 22 July 2014, p 2.

[10] Bank of England, 'Working Group on Sterling Risk-Free Reference Rates', 9 September 2021. The membership includes representatives of banks and dealers, investment managers, non-financial corporates and other sterling issuers, infrastructure firms and trade associations (ibid).

[11] Bank of England, 'Transition from LIBOR to risk-free rates', 21 July 2021.

[12] Explanatory Notes to the Financial Services Bill 2019–21, p 12.

[13] Financial Conduct Authority, *FCA Announcement on Future Cessation and Loss of Representativeness of the LIBOR Benchmarks*, 5 March 2021. The various versions of LIBOR may cease to be produced at different times, and the FCA is still consulting on final dates for some of these. For a table summarising the current position, see: Explanatory Notes, pp 4–5.

[14] Bank of England, *Financial Stability Report*, August 2020, p 85.

[15] Financial Services Act 2021, ss 8–21.

2.5 Legislative framework

The bill builds on existing legislation in this area, which has evolved through both UK- and EU-derived sources. These include:

- The **Financial Services Act 2012**. This amended the Financial Services and Markets Act 2000 to make the administration of, and contributions to, LIBOR into regulated activities.
- A **2016 EU regulation** that came into force on 1 January 2018. This introduced a regulatory framework to ensure the accuracy, robustness and integrity of benchmarks used in the EU. It was wider in scope than the previous regime. It placed regulatory requirements on administrators of benchmarks, contributors to benchmarks and supervised entities that use benchmarks.[16]
- The **Financial Services and Markets Act 2000 (Benchmarks) Regulations 2018,** SI 135/2018. These implemented aspects of the 2016 EU regulation in UK law.
- The EU regulation was taken into UK statute as **retained EU law** at the end of the Brexit transition period. This is referred to as the UK benchmarks regulation (BMR).[17]
- The **Benchmarks (Amendment and Transitional Provision) (EU Exit) Regulations 2019**, SI 657/2019. These amended the UK BMR to ensure that it operated effectively in the UK.
- The **Financial Services Act 2021** contained specific measures to respond to the risks identified from the winding down of LIBOR. It granted the FCA powers to 'designate' a critical benchmark under article 23A of BMR if the FCA believes the benchmark is, or is at risk of being, no longer accurate. Once the FCA has designated a benchmark under article 23A, it has powers to oversee its orderly wind-down.[18] These powers include prohibiting new contracts from using the benchmark and determining which legacy contracts can continue to use it. The FCA can also compel the administrator of the benchmark to continue producing it for up to ten years and can prescribe how the calculation is made.

In February 2021, the Government consulted on the case for further legislation to reduce the scope for uncertainty and litigation that might arise from the FCA's actions to wind down a designated benchmark.[19] It concluded that such legislation was desirable to avoid both the costs of legal disputes and the risk that they undermine the wind-down of LIBOR, in turn impacting the stability of the UK financial system.[20] The Government said legislation would be brought forward when parliamentary time allowed. This bill contains the resulting legislative provisions.

In May 2021, the FCA consulted on which contracts can be defined as tough legacy and on restricting

[16] The EU benchmarks regulation can be found at: OJ L 171, 29.06.2016.

[17] The version of the BMR on the UK Legislation site (legislation.gov.uk) is out of date as it has not incorporated amendments from the 2019 regulations and from the Financial Services Act 2021. The current version is available on request to the Library at hllibrary@parliament.uk.

[18] This followed a recommendation from the working group of market participants: Working Group on Sterling Risk-free Reference Rates, *Paper on the Identification of Tough Legacy Issues*, May 2020, p 3.

[19] HM Treasury, 'Supporting the wind-down of critical benchmarks: consultation', 15 February 2021.

[20] HM Treasury, 'Letter to Tushar Morzaria, Chair of the Working Group on Sterling Risk-Free Reference Rates, ref wind-down of LIBOR benchmark', 7 May 2021.

new use of critical benchmarks.[21] The provisions of this bill will only apply to tough legacy contracts; other contracts will be prohibited from using LIBOR and will need to transition to other benchmarks.[22]

The FCA published a feedback statement on the consultation on 29 September 2021.[23] It also issued two statements of policy. The first covered which contracts would be permitted to continue using a designated benchmark and the second covered the FCA's powers to prohibit new use of a critical benchmark.[24] Each statement set out a series of criteria which the FCA will use when deciding whether and how to exercise its powers in the area. For example, in the policy for determining which contracts would be permitted to continue using a designated benchmark, the FCA said these would include:[25]

- the scale and nature of the contracts;
- whether it is feasible to remove references to the designated benchmark;
- consistency with actions taken by regulators in other jurisdictions; and
- whether permitting continued use would otherwise advance the FCA's objectives.

3. Bill provisions

The bill consists of four clauses. The main provisions, which aim to provide greater legal certainty around the use of LIBOR while it is being wound down, are contained in clauses 1 and 2. Clauses 3 and 4 contain consequential and general provisions.

3.1 Clause 1: supporting the orderly wind-down of a benchmark

Clause 1 aims to provide legal certainty for parties to contracts that contain references to a benchmark designated under article 23 of BMR, such as LIBOR. They are designed to allow contracts to carry on "undisturbed" when the FCA exercises specific powers in relation to these designated benchmarks.[26]

The provisions would clarify that:

- References to a designated benchmark should continue to be interpreted as references to that benchmark after the FCA has exercised powers under the BMR. This would apply if, for example, the FCA directed a change to how LIBOR is calculated, known as introducing

[21] Financial Conduct Authority, 'CP21/15: Benchmarks regulation: how we propose to use our powers over use of critical benchmarks', 5 July 2021.

[22] Explanatory Notes, p 5.

[23] Financial Conduct Authority, *Feedback Statement: FCA Use of Powers Over Use of Critical Benchmarks*, 29 September 2021.

[24] Financial Conduct Authority, *Statement of Policy on the FCA's Power Under Article 23C Benchmark Regulations*; and *Statement of Policy on the FCA's Power Under Article 21A Benchmark Regulations*, 29 September 2021.

[25] Financial Conduct Authority, *Statement of Policy on the FCA's Power Under Article 23C Benchmark Regulations*, 29 September 2021, pp 6–9.

[26] ibid, p 6.

'synthetic LIBOR'.[27]

- Where a contract references a benchmark before the bill comes into force or before the benchmark is designated as critical, the contract will be treated as if it has always referenced the benchmark. This is intended to ensure that an FCA action, such as designating a benchmark as critical or changing the way it is calculated, does not provide grounds to argue there has been a breach of contract.
- All references to a critical benchmark are included within the scope of the BMR as amended by the bill, however these references are expressed. The Government states that this widens the current definition in the BMR of a "use" of a benchmark.[28]
- For contracts that reference one benchmark (such as LIBOR) but have a fallback clause allowing a reference to a different benchmark, the bill would not override this mechanism. However, the bill would ensure that fallback clauses triggered by the cessation or unavailability of the benchmark would not be activated by certain FCA actions. These include where the FCA uses its powers to provide for the continued publication of the benchmark with a revised methodology, as in the case of synthetic LIBOR.

3.2 Clause 2: administrator protections

The Government's February 2021 consultation identified a risk that administrators of benchmarks could be subject to legal action as a result of complying with statutory requirements imposed upon them by the FCA.[29] Again, the Government cites the example of the FCA instructing an administrator to change the methodology for calculating a benchmark.[30] The Government states legal action would impose an "unmerited" burden on the administrator and could undermine the orderly wind-down of the benchmark.

Therefore, clause 2 would grant the administrator of a critical benchmark immunity from legal action where it acts in accordance with requirements imposed by the FCA under the BMR. It is also intended to protect the administrator where it publishes a benchmark as calculated in accordance with those requirements.

The immunity does not cover actions where the administrator exercises a discretion conferred upon it by the FCA.

3.3 Clauses 3 and 4: general provisions

Clause 3 contains a consequential provision that amends the existing BMR text to ensure it does not limit the new provisions. It also ensures that each version of a critical benchmark (for example, in different currencies and/or maturities) is treated as a separate benchmark.

Clause 4 contains a definition of the existing BMR (as described in section 2.5 of this briefing). It also

---

[27] The FCA's consultation on how synthetic LIBOR might be calculated can be found at: Financial Conduct Authority, 'CP21/19: Proposed decision under Article 23D BMR for six sterling and yen LIBOR settings', 13 September 2021. One commentator has argued that synthetic LIBOR is "neither synthetic nor will it likely be the rate that the term 'LIBOR' has defined since it was first used": Erik Schneider, "Synthetic LIBOR'—what is it?', Nixon Peabody, 29 October 2020.

[28] Explanatory Notes, p 7.

[29] HM Treasury, *Supporting the Wind-down of Critical Benchmarks: Consultation*, 15 February 2021, p 9.

[30] Explanatory Notes, p 7.

sets out the bill's territorial extent, commencement and short title. The bill extends to the whole of the UK. It would come into force on the day it received royal assent.

4. External commentary

In April 2021, the working group of market participants said there was "strong and broad support for safe harbour protections".[31] It said provisions should confirm continuity of contracts and provide protection from "specific legal claims that may arise against supervised entities, non-supervised entities and the administrator of LIBOR".

Since the bill has been published, law firm Herbert Smith Freehills (HSF) has suggested that, while the bill seeks to address contract continuity, it does not provide such complete "safe harbour" protection from all claims relating to the designated benchmark.[32] For example, it said "speculative mis-selling type claims" might still be possible. Further, it argued the impact of some of the bill's provisions was unclear and would become the subject of court interpretation. HSF also stated that the equivalent legislation in the US had introduced a more comprehensive safe harbour. In a separate article, TLT Solicitors agreed this was a "surprising" omission from the UK bill.[33]

HSF has also argued that the question of which contracts will be considered to be 'tough legacy' contracts, and will therefore be able to continue using LIBOR and synthetic LIBOR, remains "all-important".[34] HSF stated that if the definition of tough legacy is narrow, fewer contracts will fall under the scope of the bill, meaning greater scope for continuity issues in other contracts. The firm also suggested that the delay in defining tough legacy contracts has been a "source of significant frustration to many market participants".

HSF welcomed the fact that the contract continuity provisions could apply to non-supervised entities and products outside the scope of the UK BMR, as well as to supervised entities. It said this was a "wide safety net afforded to non-financial contracts".

Law firm Clifford Chance has stated that fallback provisions in contracts will need "careful consideration" in light of the bill.[35]

5. Read more

- Catherine Wong, 'LIBOR cessation: what are the litigation risks for legacy contracts entered into before July 2017 that extend beyond 2021?', *Journal of International Banking Law and Regulation*, 2020, vol 35 no 11, pp 475–82

---

[31] Working Group on Sterling Risk-Free Reference Rates, 'Letter to Economic Secretary to the Treasury ref safe harbour provisions to support the wind-down of critical benchmarks', 21 April 2021.

[32] Jenny Stainsby et al, 'The UK's LIBOR safe harbour legislation: a missed opportunity?', Herbert Smith Freehills for Lexology, 8 September 2021.

[33] Nick Curling, 'The Critical Benchmarks Bill—latest piece of the LIBOR cessation jigsaw', TLT Solicitors, 17 September 2021.

[34] Jenny Stainsby et al, 'LIBOR transition: critical FCA consultation on 'tough legacy' definition', Herbert Smith Freehills, 28 May 2021.

[35] Clifford Chance, *Synthetic LIBOR and UK Contract Continuity: Critical Benchmarks (References and Administrators' Liability) Bill*, September 2021.

About the Library

A full list of Lords Library briefings is available on the Library's website.

The Library publishes briefings for all major items of business debated in the House of Lords. The Library also publishes briefings on the House of Lords itself and other subjects that may be of interest to Members.

Library briefings are produced for the benefit of Members of the House of Lords. They provide impartial, authoritative, politically balanced information in support of Members' parliamentary duties. They are intended as a general briefing only and should not be relied on as a substitute for specific advice.

Every effort is made to ensure that the information contained in Lords Library briefings is correct at the time of publication. Readers should be aware however that briefings are not necessarily updated or otherwise amended to reflect subsequent changes.

Disclaimer

Authors are available to discuss the contents of the briefings with the Members and their staff but cannot advise members of the general public.

Any comments on Library briefings should be sent to the Head of Research Services, House of Lords Library, London SW1A 0PW or emailed to hlresearchservices@parliament.uk.