Davis Polk

CLIENT MEMORANDUM

UK Government Announces Enhanced FCA Powers to Deal with "Tough Legacy" LIBOR Contracts

June 26, 2020

Highlighting that legislative steps could help address the "tough legacy" contracts that cannot transition from LIBOR, the **UK Government** announced on June 23 its intention to expand the powers of the UK Financial Conduct Authority (the "**FCA**") to allow it to require an administrator to change the methodology of a critical benchmark and clarify the purpose for which the FCA may exercise this power. These powers could be used by the FCA to modify LIBOR to permit its continued use in modified form for those legacy contracts to allow them to wind down to maturity without needing to transition away from LIBOR.

On the same day, the **FCA** published a statement welcoming the announcement, noting that its proposed enhanced powers could help manage and direct an orderly wind-down of critical benchmarks such as LIBOR and, in particular, help deal with the problem of "tough legacy" contracts that cannot transition from LIBOR. The FCA explained that the legislation would empower it to protect those who cannot amend their contracts by directing the administrator of LIBOR to change the methodology used to compile the benchmark if doing so would protect consumers and market integrity. The FCA added that:

> Although this would not make the benchmark representative again, it would allow the FCA to stabilise certain LIBOR rates during a wind-down period so that limited use in legacy contracts could continue, if suitable robust inputs to support such a methodology change are available.

In a separate publication also published on the same day, the **FCA** explained that:

> The proposed changes will create a possible way of reducing disruption to holders of 'tough legacy' LIBOR contracts (i.e. contracts that genuinely have no or inappropriate alternatives and no realistic ability to be renegotiated or amended) by enabling continued publication of a LIBOR number using a different and more robust methodology and inputs.
>
> The representativeness of LIBOR would not be restored by such a methodology change. However, as the Risk Free Rate Working Group has recommended to authorities, tough legacy contract holders would face considerable disruption from an abrupt cessation of LIBOR. This could be significantly reduced if LIBOR could be produced using a different methodology and inputs which provide a reasonable approximation of its expected future value from the date that the methodology changes.

The FCA further announced that it will seek market input on feasible and robust methodology changes. However, the FCA, as well as the UK Government, expressly stated that these changes do not mean that the transition from LIBOR is no longer necessary and stressed that continued focus on transition remains both necessary and desirable for those who can reduce or remove their current reliance on LIBOR. Moreover, the FCA emphasized that the legislation does not mean that LIBOR's methodology will be changed, but that it will make it possible to require such a change in specific circumstances to promote an orderly transition.

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