International Capital Market Services Association (ICMSA)

Consultation on Supporting the wind-down of critical benchmarks
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HM TREASURY CONSULTATION ON SUPPORTING THE WIND-DOWN OF CRITICAL BENCHMARKS

Dear Sirs,

We refer to the HM Treasury consultation document entitled "Supporting the wind down of critical benchmarks" dated February 2021. We welcome the opportunity to provide the views of the IBOR Transition Working Group of the International Capital Market Services Association on the proposal, as set out in that document, for the implementation of a legal “safe harbour” for contracts that reference or rely upon an Article 23A[1] benchmark including such a benchmark as it is published under a changed methodology promulgated by the FCA using its powers under Article 23D (the "**Safe Harbour**").

Below you will find our response to Question 7 of the consultation.

7. ***Should any legal safe harbour apply to third parties such as facility agents, trustees or parties to contracts ancillary/collateral to the main contract that reference or rely upon an Article 23A benchmark? If so, how?***

We welcome the proposal to implement the Safe Harbour. Given the potentially significant disruption that could result from litigation due to contractual uncertainty arising out of the publication of LIBOR in a synthetic form, immunity from litigation to those who are most closely associated with the ongoing operation of debt securities transactions would be a proportionate step to support the orderly wind-down of LIBOR. Accordingly, the view of our membership is that the Safe Harbour should apply to all transaction service providers that are party to debt securities transactions contracts that reference or rely upon an Article 23A benchmark.

Our response below is predicated on the assumption that any benchmark that will be published under a changed methodology promulgated by the FCA using its powers under Article 23D, will take effect as a direct and simple substitution of the relevant screen rate. Any calculations and adjustments necessary in practice to implement the changed methodology would be “behind the scenes” and the resultant published rate would be capable of being applied to existing contracts without the need for any consequential changes either to the documentation or the methodology of any calculation that is based on that benchmark (as such methodology is already provided for in the relevant contracts) or the existing documentation would be capable of being construed in accordance with the applicable legislation. For contracts where this is not the case and instead the modified benchmark either expressly or impliedly requires consequential or conforming changes to the documentation for it to replace the existing benchmark, primary legislation (such as the Financial Services Bill) will need to provide an express ability for parties to make such conforming changes or include deeming language as to how any existing provisions will be construed going forward. At a high level, the scope of such legislation would need to include either (i) a prescribed or recommended methodology or approach for implementing such changes (c.f. the ARRC’s legislative proposal for contracts governed by New York law) or (ii) a permissive provision allowing parties to amend contractual provisions

[1] References to Articles herein are to the EU Benchmarks Regulation (Regulation (EU) 2016/1011) as it forms part of UK domestic law by virtue of the European Union (Withdrawal) Act 2018 (as amended by the European Union (Withdrawal Agreement) Act 2020).

to the extent necessary to permit the proper operation of the Article 23A benchmark. Further comprehensive safe harbour provisions that dovetail with such provisions, so as to protect all parties involved in implementing the use of the modified benchmark and making such amendments, would be critical. Without both of these elements, for contracts where conforming changes are necessary, there is a significant risk that parties will not be able to use the changed methodology properly or contractually implement an Article 23A benchmark in order to move away from legacy LIBOR.

Debt securities issuances that reference or rely upon an Article 23A benchmark will typically involve a number of agents appointed by the issuer to carry out various duties on its behalf, including calculating the interest amount payable on the notes and facilitating the payment of interest to noteholders. Many of these issuances will also involve a trustee appointed to represent the interests of noteholders and there could also be a security trustee as part of the same or a separate role, appointed to hold any security interests granted for the benefit of the secured creditors (including noteholders). Such debt securities are typically held by end investors in the international clearing systems though an intermediated and layered custody structure which is both complex and facilitates the securities being widely held in the international markets (including by retail investors). It is therefore endemic to the debt capital markets that there is (i) a wide range of parties impacted by the introduction of synthetic LIBOR, (ii) a wide range of potential litigants and (iii) a heightened degree of risk for direct market participants such as the service-provider community.

Our members, between them, are involved in most, if not all, of the legacy debt securities transactions that reference or rely upon benchmarks that are liable in the short-term to become Article 23A benchmarks. Our members face significant uncertainty in relation to those transactions that are based on Article 23A benchmarks where the commercial parties have not successfully agreed replacement benchmarks and this uncertainty will prove disruptive for the market in general. The potential for disruption and litigation caused by this uncertainty can be significantly reduced by a Safe Harbour that protects service providers as comprehensively as possible.

The effective implementation of a decision by the FCA to designate a benchmark as an Article 23A benchmark, and to amend any such benchmark's methodology using its powers under Article 23D, will in many cases depend on service providers such as our members being able to confidently facilitate the smooth transition of transactions subject to such benchmarks in such a way that minimises any potential market disruption and without fear of litigation.

Anyone seeking to bring a claim based on an Article 23A designation and/or Article 23D change of methodology in relation to a debt securities transaction may well seek to include one or more of the service providers as defendants. This may happen as a result of a strategic decision by a claimant to include all parties to the transaction or specifically to target the "deep pockets" of the service providers. The latter is a particularly acute risk in an environment where parties at risk of losing out financially as a result of the transition of transactions, may consider the use of the FCA's powers under Articles 23A and 23D as an opportunity to bring claims.

Note trustees will hold the benefit of a series of covenants (including the covenant to pay interest and principal on the notes) given by the issuer under the terms of the transaction documents on trust for the noteholders. Trustees have a duty to act with care and skill in the administration of their trusts and owe certain fiduciary duties to noteholders. For those issuances with a trustee, the transaction documents will make clear that the trustee, rather than the noteholders, is responsible for enforcing the obligations of the issuer, including the obligation to pay interest and principal on the notes in accordance with the payment provisions prescribed in the transaction documents. As described above, service providers owe various contractual duties under the transaction documents and in certain cases (in relation to note trustees and security trustees) fiduciary duties and, depending on the circumstances, a claimant may also seek to assert duties under other legal principles such as tort. Those agents which undertake calculation and payment duties in relation to interest rate payment provisions as well as trustees are therefore particularly vulnerable to vexatious litigation claims if contractual counterparties and/or noteholders are perceived to suffer losses as a result of an Article 23A designation or Article 23D change to its methodology.

Our membership is supportive of a comprehensive Safe Harbour which expressly provides both for contractual continuity and protection from claims. Contractual certainty is a key concern for our membership, not only to ensure that the market is not beleaguered by disruption but because of the real risk of litigation being brought against trustees and/or agents arising out of any uncertainty around the status of the contractual arrangements to which they are party. For example, where an issuer or other transaction party asserts that it is not obliged to perform contractual obligations on the basis that the benchmark subject to an Article 23A designation and Article 23D methodology change no longer exists, a noteholder may seek to attach liability to the trustee and/or any of the agents for the resultant failure of the contract. Debt securities service providers are typically appointed to perform largely administrative and ministerial duties and their remuneration is relatively minimal in the context of the value of the

debt they are appointed to service. Our members are therefore exposed to claims that are hugely disproportionate to the commercial basis on which they have been appointed to act.

Without a comprehensive protection from claims, trustees and agents face a significant risk that claims will be brought alleging that, in relying on the combined operation of Article 23A and Article 23D, they have breached their liability standard under the documents. These claims could be brought in contract or tort. Additionally, as we described above, trustees also have a relationship with noteholders and/or secured parties governed by the law of equity. Therefore, in seeking to rely on any primary legislation providing for the automatic transition of a critical benchmark, trustees may face claims for breach of trust from such beneficiaries. We therefore ask that HM Treasury consider including broad and comprehensive protection from claims in any Safe Harbour to ensure that debt securities transaction service providers are properly insulated from all causes of action that might be brought against them (whether in contract, tort or equity) as a consequence of relying on the designation of a critical benchmark as an Article 23A benchmark and a change to its methodology under Article 23D.

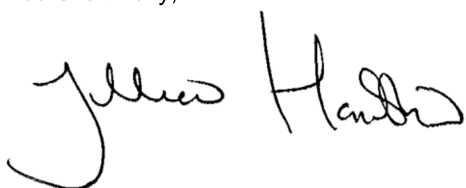
We note that HM Treasury observes in paragraph 3.2 of the consultation paper that "*the UK can only provide a possible legal safe harbour for contracts governed by UK law*". We would ask though that HM Treasury also considers ways of ensuring that the Safe Harbour extends so as to act as a defence to any claim based on the laws of the UK whether in contract, equity, tort or otherwise (for instance in relation to breach of trust). For example, it's possible that a noteholder or secured party may bring a tortious claim for negligence against a service provider based in London before the English courts notwithstanding that the governing law of the transaction is not English law and the contracting parties have agreed to bring contractual claims exclusively before the courts of a different jurisdiction. In such circumstances, it would be important for the relevant service provider to be able to rely on the Safe Harbour to defend such a claim, irrespective of whether the transaction documents were governed by a UK law.

Our members are concerned that, even in respect of those transactions governed by English law, affected parties may look to bring a claim against the trustee and/or any agents or seek to contest whether the contract falls within the scope of the FCA's powers of intervention under Article 23D in another jurisdiction. We would therefore encourage HM Treasury to ensure that any Safe Harbour applicable to debt securities service providers is both comprehensive and has wide extraterritorial effect. For example, HM Treasury might explore providing in the relevant legislation that any judgment or award obtained under a law other than a law of the UK, is not enforceable in the UK to the extent that it imposes liability on a party that would not attach to that party under UK laws were the claim to fall within the ambit of the Safe Harbour.

Finally, we would ask HM Treasury to note that many transactions involving the use of Article 23A benchmarks are highly complex with numerous parties and interlocking contractual relationships so that any matter affecting a benchmark as it operates in one component of the transaction may have knock-on effects on other components of the transaction. An obvious example is where there are interest rate hedges taken out by a party to the transaction which operate by reference to the benchmark. In addition, the market has numerous products pursuant to which otherwise unrelated transactions are connected, such as through credit-linked and repackaged securities and derivative products, such that parties quite distant from an underlying transaction may be affected economically as a result of an Article 23A benchmark designation which primarily affects that underlying transaction. Whilst, no doubt, the exposure of our members to liability to parties other than their direct contractual counterparties becomes more remote with distance, given the almost limitless reach of potential consequences, it is nevertheless important that the Safe Harbour is written as comprehensively as possible to also shield agents and trustees from litigation arising out of these more distant connections.

Please note that this response may not necessarily reflect the views of all ICMSA members but has been written and approved with input from a representative sub-group of the membership.

Yours faithfully,



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