

Benchmarks Update

FCA Consultation Paper sets out proposed approach to compelling LIBOR contributions.

The FCA has published a Consultation Paper ([CP17/5](#)), setting out its proposed approach to the use of its compulsion powers under the EU Benchmarks Regulation (BMR) in relation to LIBOR.

It is expected that the European Commission will designate LIBOR as a “critical” benchmark either later this year or when the remaining provisions of the BMR come into force on 1 January 2018. When that happens, the FCA will have powers under the BMR to require contributions to LIBOR, and so it is gearing up now for how it might use those powers, should this prove necessary.

The FCA is seeking feedback on its proposals by 12 August 2017, with a view to publishing a Policy Statement in September 2017.

The consultation also provides an update on the projected timing of the FCA’s main Consultation Paper on the changes to its Handbook required before the BMR comes fully into force. This consultation has been expected for some time and was thought to be due for publication this month. However, the FCA now states that it is due “in the next few months”, suggesting that publication may not be imminent.

The FCA’s approach

The FCA already has powers under the Financial Services and Markets Act 2000 to compel contributions to LIBOR should this be considered necessary. However, once LIBOR is designated as critical under the BMR, the FCA will be obliged to use the power under the BMR instead if it wishes to compel firms that are “supervised entities” (broadly, EU authorised financial services firms) to contribute. Therefore, the BMR power will, in some respects, replace the existing domestic powers.

When using the BMR power, the FCA will need to follow the BMR parameters. In particular, the FCA will be expected (although not obliged) to apply ESMA’s recently published [methodological framework](#) for the selection of firms for mandatory contribution to critical benchmarks under the BMR. Therefore, the FCA is consulting on how it will approach the use of the new BMR power.

The FCA’s proposed approach is to seek to use its compulsion powers only where appropriate in pursuit of its market integrity or consumer protection statutory objectives, and the FCA does not envisage supporting LIBOR by compelling contribution on an indefinite basis. A key factor for the FCA in terms of LIBOR’s necessity for market integrity is whether credible alternative interest rate benchmarks are available to market participants. In this regard, the FCA highlights the current work underway on reforming major interest rate benchmarks, suggesting that in future it may not necessarily consider the

use of its compulsion powers essential were one of the LIBOR panel banks to notify its intention to cease contributing.

The FCA also clarifies that, if it were to use its powers of compulsion, it would not expect to seek to increase the number of contributors significantly above the current level, and it may not necessarily seek to compel contributions in relation to all maturities for each currency.

Who might be compelled?

The FCA sets out its thinking around how it would establish which banks to compel, noting that under its current domestic powers there are no prescribed criteria around who can be compelled to contribute to LIBOR.

This scoping is important, as under the BMR if a panel bank notifies its intention to stop contributing to LIBOR, the FCA can only require it to keep contributing for four weeks in the first instance. After that, it would need to exercise the full BMR compulsion power, having applied the requisite test.

As the FCA needs various data that it does not currently hold in order to apply this test, it is asking for data now and seeking to establish how it would assess which banks to compel. The FCA hopes that this way it will have more chance of acting within the required timeframe if this proves necessary, although the timing is still likely to prove very tight.

Under the BMR, compulsion must be based upon actual and potential participation in the relevant market. The FCA's view is that, to maintain the existing quality of LIBOR, it should select banks of a similar quality to the existing panel banks. Consequently, it proposes to define the relevant market as "the interbank and corporate unsecured wholesale funding market for GBP, USD, EUR, CHF and JPY involving large banks that have good credit quality and a presence in the United Kingdom".

The FCA intends to seek further data from banks that are: (i) of a similar size to existing LIBOR panel banks (measured by group-wide total assets); (ii) have good credit quality (including only those banks with investment grade issued debt); and (iii) have a presence in the UK, in order to measure their actual or potential participation in the above market. The FCA would then rank them in terms of their appropriateness for the panel, using a scorecard method.

The FCA is gathering data from around 50 banks matching the above criteria, in order to help it calibrate its approach to ranking and weighting various factors when measuring actual or potential participation. As LIBOR contribution comes with various associated costs and compliance requirements, banks approached by the regulator should respond to the consultation if they feel compulsory contribution would be unduly burdensome from a costs perspective.

Continued use of UK powers

The consultation also sets out a draft rule that the FCA could use to compel banks to contribute under UK law, should this prove necessary before LIBOR is designated as a critical benchmark. This rule would operate in a manner similar to the BMR powers.

However, the FCA does not plan to make this rule unless it considers it necessary to do so. It would specify the banks required to contribute in the rule itself, although it would plan to give those banks an opportunity to make representations first. It would also look to allow any bank required to contribute for the first time an interval to allow it to develop the necessary systems before requiring contribution.

Further, the FCA states that it is considering the issue of whether branches of third country firms fall within scope of the BMR compulsion powers, noting that the BMR is not clear on this point. Its position is that, to the extent such branches fall outside scope of the BMR power, it considers the existing UK powers could be used to require them to contribute.

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