HM Treasury Consultation

Supporting the wind-down of critical benchmarks

Submission by Barclays

Barclays is a transatlantic consumer and wholesale bank with global reach, offering products and services across personal, corporate and investment banking, credit cards and wealth management, with a strong presence in our two home markets of the UK and the US. With over 325 years of history and expertise in banking, Barclays operates in over 40 countries and employs approximately 85,000 people. Barclays moves, lends, invests and protects money for customers and clients worldwide.

Barclays welcomes this review into supporting the wind-down of critical benchmarks. Given the dual regulatory objectives of (i) consumer protection, and (ii) market integrity, a key policy priority in the context of London Inter-bank Offered Rate (LIBOR) transition is to minimise market disruption and increase contractual certainty. The UK legislative proposals for a synthetic LIBOR help further such objectives, in that they facilitate the transition of "tough legacy" products that cannot be easily transitioned by agreement. In the same vein, it is in the interest of all market participants to ensure regulatory and legislative efforts to support a smooth transition are not subsequently derailed by civil litigation. We therefore believe it is imperative that the UK should legislate for a safe-harbour provision in order to support the wind-down of critical benchmarks.

Consultation Questions

(Chapter 2 - Box 2.A: Questions)

- **If a critical benchmark is designated as an Article 23A benchmark, and subject to a possible change in methodology under Article 23D, how might this create contractual uncertainty?**
    - We would draw attention to the following general considerations: (i) note that we are responding to this consultation when the market and industry doesn't yet know what the definition of tough legacy is; (ii) furthermore this is not just about uncertainty from the banks' perspective – the entire market is exposed to uncertainty if claims proliferate resulting from LIBOR discontinuance and the imposition of statutorily prescribed synthetic LIBOR rates.
    - Contractual uncertainty arises where such a benchmark is subject to a possible change in methodology under Article 23D, should parties disagree with the commercial result of the methodology change, creating litigation risk. Specifically, parties are vulnerable to claims from borrowers, investors and customers, when comparing the interest paid and received before and after the move to synthetic LIBOR or a rate selected using discretion. In and of itself, the amounts at stake can provide an incentive to litigate.

- Contractual uncertainty also arises in the form of interpretation issues, with respect to existing references to LIBOR in contracts and whether these would be construed as being replaced by a synthetic LIBOR (i.e., a benchmark labelled LIBOR, that is available in the same way as LIBOR, but calculated in a materially different way).

- Uncertainty also arises as the scope of the tough legacy contracts subject to the FCA powers (which is subject to a separate consultation by the FCA on their powers under Article 23C) is currently not clear. Given market participants cannot currently define tough legacy, this could potentially lead to counterparty delays in engaging in the transition remediation effort.

- Statutory contract continuity provisions would prevent parties from contesting the transition to the designated synthetic LIBOR rates, and a statutory safe-harbour provision would reduce related litigation risk associated with the transition (including issues arising where contractual fallback triggers do not take effect and the scope of tough legacy is not wide enough to encompass such contracts which have not been actively transitioned).

- **Subject to responses to the previous question, would this contractual uncertainty lead to causes of action, potential liabilities or grounds for litigation, between parties to contracts, or between other parties? If yes, please specify:**

  - **the nature of the causes of action, liabilities or grounds for litigation that could arise**

    - Parties may refuse to engage in transition discussions with the intention of using litigation to leverage their position commercially. Preventing this sort of opportunistic litigation would mean there is nothing to be gained from delaying transition or refusing to engage in discussions.

    - There is an ongoing risk that some market participants will employ aggressive trading strategies to trade into existing structures with perceived vulnerabilities and use litigation to leverage their position. Protection from litigation would discourage and prevent that market disrupting activity and enable lenders and businesses to effect smooth transition.

    - Protection from claims is not just about uncertainty in interpretation and parties being unsure what they should do under the contract/legislation. The proposals at the moment appear narrow with no mention of tortious claims or statutory misrepresentation. Litigation risk includes mis-selling claims: e.g., the claimant alleges that they entered into a financial contract based on legacy LIBOR but this has now changed due to synthetic LIBOR. There is a particular risk is that claims arise with respect to contracts entered into in the period post July 2017 (and post the Andrew Bailey announcement) when there was uncertainty, no clear alternatives and no clear guidance as to LIBOR replacement. Absent safe harbour protection, there is a significant risk (one could even say an inevitability) of large numbers of claims supported by litigation funders and/or claimant law firms. There will be a considerable amount of market disruption as banks deal with these claims over a number of years. A safe harbour would serve to avoid vexatious and unsubstantiated claims. Whilst it may appear to offer broad protection for banks, this protection would not prevent regulators examining the conduct of banks and, should they discover any circumstances that result in an adverse position to customers and clients, these can be remedied and redressed through the investigative process.

- We are aware of a potential contractual interpretation issue with respect to existing references to LIBOR in contracts and whether these would be construed as being replaced by synthetic LIBOR (i.e., a benchmark labelled LIBOR, that is available in the same way as LIBOR, but calculated in a materially different way). In that context, material changes to the methodology may either, depending on the fall-back wording: (i) trigger contractual obligations, including fall-back language, or obligations to notify a change in the rate to synthetic LIBOR; or (ii) give rise to uncertainty as to whether such contractual fall-backs have been properly triggered.

- By publishing synthetic LIBOR, a rate would exist which, absent any protection from litigation, parties could use to compare against the performance of an industry-wide recommended benchmark replacement (a "Recognised Alternative Risk Free Rate") to which they have transitioned, and bring a claim for any difference in value and consequential losses.

- Other potential claims arising from LIBOR transition include challenges to the credit adjustment spread, calculation/determination agent discretion, and the application of fall-back language (e.g., upon cessation events).

- Calculation Agents/Determination Agents are responsible for performing the calculations set out in transaction documentation, applying the interest rate provisions, making determinations required under the contract and communicating interest repayment amounts to issuers, and they are therefore exposed to litigation risk from investors/parties to the contracts. Determination Agents exercising discretion (i) when determining when to replace LIBOR in contracts and (ii) by applying the industry recommended benchmark replacement (i.e., selecting a workable fallback on a unilateral basis rather than by active transition) are also exposed to litigation risk, and this creates contractual uncertainty.

- A specific example of the litigation risk relates to ISDA 2020 IBOR Fallbacks Protocol adherence is as follows. Whilst safe harbour does not solve the issue of parties delaying adherence to the Protocol, we would highlight the risk that early adopters may try to bring a claim if, in adopting early, they suffer some detriment. Such detriment could centre on the spread methodology leading to an economic advantage for USD lenders (to the detriment of USD borrowers). This could arise as the spread adjustment for the mainstream USD LIBOR tenors will be fixed much earlier than the cessation date given the FCA cessation announcement on 5 March 2021, the push-out of USD LIBOR cessation in the mainstream tenors until 30 June 2023, and the way the Protocol works, involving calculation of the spread adjustment upon the announcement of the cessation by the UK FCA but which is not effective until 30 June 2023. The economic difference between USD LIBOR and SOFR has been on a downward path and the difference in the 5-year median is expected to decrease, according to our published Barclays research. For example, the current LIBOR/SOFR spread differential (currently the spread difference in 3-month LIBOR / SOFR compounded in arrears is around 12.4bps) is likely to stay low as bank credit spreads remain tight given current central bank policy as a result of COVID. This risk is easily resolved by a safe harbour preventing such claims.

- Litigation risks might arise as a result of differences between EU, US and UK tough legacy measures, and forum-shopping; i.e., in the absence of a UK safe-harbour, there may be increased litigation in the UK, as such claims are not possible in the EU and the US due to the EU and US safe-harbours in effect. If the UK tough legacy definition is narrow, there is risk that contracts would fall outside of the scope of tough legacy in the UK, but would potentially be caught by the wider tough legacy definition in the EU, and this could lead to forum shopping with parties looking to bring claims in the EU seeking the benefits of the EU solution, therefore we need a wide scope for tough legacy in addition to the safe-harbour.

- **how likely they would be, under the circumstances and the likely timing in which these could arise**

  - We expect claims such as those identified above to be highly likely and we refer to the articles/publications from litigation law firms that support this statement as referenced further below.

  - In terms of timing for potential litigation risk arising, we believe litigation is very likely and will increasingly start to arise from the second half of 2021. We also envisage broader litigation risks increasing from beyond the second half of 2021, and with litigation increasing after application of synthetic LIBOR post 2021.

- **possible impacts (quantitative and qualitative) on contractual parties and the wider impact**

    - LIBOR transition litigation is a real risk to the market: as the Financial Times reported, the end of LIBOR is a "DEFCON 1 litigation event". Claimant law firms and litigation funders have identified the potential for claims in articles recently published.

    - Absent legislative protection against litigation, market participants risk becoming embroiled in lengthy disputes. Such litigation risks delaying transition, not only for the parties to the litigation, but for the broader market as it awaits the legal outcome. In turn, this will undermine the FCA objective of achieving a smooth transition to risk-free rates. Conversely, introducing protection against litigation will remove this uncertainty from the market. Specifically, it will remove an incentive for parties to delay transition and seek to leverage their position through litigation.

    - A safe-harbour should provide statutory protection against the risk of litigation from claims of contract frustration and force majeure, and for statutory contract continuity, as well as immunity from all related claims, including miss-selling and misrepresentation claims, as further detailed below. The legislative protection should cover the possible litigation risk scenarios as described herein, thus avoiding litigation over whether the legislation applies to a given product and/or contract. We would propose that the safe-harbour protection extends to parties and agents who exercise discretion when determining when to replace LIBOR in contracts and who use their discretion by applying a Recognised Alternative Risk Free Rate. This would ensure parity in the rights of parties who transition away from LIBOR to Recognised Alternative Risk Free Rates and parties whose products will transition via synthetic LIBOR.

- **Do you consider that a legal safe harbour is necessary in order to mitigate the impacts you have identified in response to the questions above?**

    - Yes. It would reduce the potential for market disruption, and enhance market stability. Specifically, the safe harbour would facilitate legal certainty for all contracts involving "Affected Parties" (which should include benchmark administrators, calculation/paying/determination agents, trustees, regulated/supervised and unregulated/unsupervised entities and lenders).

    - From a public policy perspective, it is important that LIBOR transition, and efforts to facilitate the publication of a synthetic rate to aid contract continuity, are not derailed by litigation. Litigation and the inevitable delay in resolving disputes will delay transition, not only for the parties to the litigation, but for the broader market participants who await the legal outcome. In the interim there would be uncertainty over parties' rights and obligations.

- Given the dual regulatory objectives of consumer protection and market integrity, a key policy priority in the context of LIBOR transition is to minimise market disruption and increase contractual certainty. The UK legislative proposals for a synthetic LIBOR help further such objectives, in that they facilitate the transition of "tough legacy" products that cannot be easily transitioned by agreement. In the same vein, it is in the interest of all market participants to ensure regulatory and legislative efforts to support a smooth transition are not subsequently derailed by litigation.

- A statutory safe-harbour will promote the stated policy objective of allowing an orderly cessation of a benchmark and the orderly transition by the market (advancing the consumer protection and market integrity objectives) and supporting the market in transitioning away from LIBOR.

- Preventing litigation provides certainty of transition for all market parties, including SMEs. Market participants would be able to focus on their businesses and maintain their investments, rather than becoming diverted by litigation. As noted above, there are already claimant law firms contemplating LIBOR transition litigation.

- Protection from litigation encourages an orderly and early transition. If there is no prospect of litigation, and there is parity in the position for products transitioned by use of discretion, and which transition via synthetic LIBOR, parties will be encouraged to actively transition in a timely manner.

- Where parties might otherwise decline or refuse to engage in transition efforts, with safe harbour protection, an Affected Party (as discussed below) can safely and without fear of recourse, take the steps necessary to transition to a Recognised Alternative Risk Free Rate.

- There is no risk to consumers through the introduction of safe harbour provisions. Regulators can still investigate regulated entities and, if wrongdoing is identified, ensure that adverse consequences vis-à-vis such consumers are remediated.

- Finally, we note the existence of legislative moves in both the EU and US, which, whilst different in form to the proposed UK legislation, do propose or reference safe-harbour provisions in recognition of the litigation risk. Global regulatory misalignment would be a negative outcome for market participants operating in international markets, resulting in unequal and possibly conflicting regulatory protection. This has the potential to produce an un-level playing field to the disadvantage of UK banks as well as increasing market uncertainty. We note, in particular, that the ARRC and NY State legislation draft proposal is more extensive in its protections than the EU text, which has been politically agreed. There is a risk of conflict or overlap between the proposed UK legislative proposals with that of the

EU or US. For example, the proposed scope of the EU legislation covers contracts with EU supervised entities, which could include English law contracts. This gives rise to the potential for disputes as to which regime should apply.

If you consider that there is a material need for a legal safe harbour to be introduced:

- **Should any legal safe harbour contain the features highlighted by HM Treasury's stakeholder feedback (as set out in Chapter 1)? Please set out your reasoning, with reference to the Financial Services Bill provisions.**

  - Although we agree with the features set out in Chapter 1, we also make the argument for the broader safe harbour on par with the US legislative proposal, which is broad, covering contract continuity and safe-harbour from claims of misrepresentation and mis-selling, and broader than the EU legislative proposal of contract continuity. In terms of scope, we would propose this covers direct and indirect use by Affected Parties in all applicable contracts and financial instruments, including, without limitation, all loans, bonds, derivatives, wholesale and retail lending/deposits. The safe-harbour provisions should apply to all relevant contracts, securities, loans, derivatives and legacy instruments. We note that the scope of tough legacy is yet to be determined and is subject to industry consultation by the FCA.

  - Specifically, the legal safe harbour should have the following features:

    - Provide a safe-harbour from litigation for Affected Parties that directly or indirectly use or reference the statutory replacement rate in respect of tough legacy contracts (as will be defined by the FCA), or where parties exercise discretion to select a Recognised Alternative Risk Free Rate, and as applicable actively transitioned contracts that would be caught within a wider definition of tough legacy contracts to be consulted on and defined by the FCA later in 2021.

    - Provide for contract continuity, so that parties to any contract, security or instrument cannot assert that the change or changes to the benchmark arising as a result of the exercise by the FCA of its powers, is anything other than a continuation of the benchmark referenced in the relevant contract, security or instrument.

    - Prevent parties to a contract from discharging or excusing performance under any contract, security or instrument for any reason, claim or defence (including, but not limited to, contract frustration or under any force majeure or other provision in any contract, security or instrument).

    - Not give any person the right to terminate unilaterally or suspend performance under any contract, security or instrument.

- Not constitute a breach of any contract, security or instrument.

- Not void or nullify any contract, security or instrument, or have the effect of amending, modifying or novating any contract, security or instrument.

- No claims or causes of action in law or equity should arise, and no Affected Party shall have any liability for damages to any person or be subject to any claim or request for equitable relief arising out of or related to determining or calculating amounts by reference to, or any direct or indirect use of a benchmark, for the purposes of any contract, security or instrument that references the benchmark or any legacy benchmark.

- Avoid a party to a contract involving an Affected Party refusing to perform its contractual obligations or declaring a breach of contract as a result of the discontinuance of a benchmark whose cessation would result in significant disruption in the functioning of financial markets.

- "Affected Party" should be defined to include, but not limited to: administrators, calculation/paying/determination agents, trustees, unregulated or regulated/supervised entities and wholesale and retail consumers and lenders.

- The safe-harbour provision should not be time-limited and should apply to contracts governed by the laws of England and Wales, and as applicable the laws of Northern Ireland and Scotland.

▪ **Are there any circumstances in which we should explicitly exclude the application of a legal safe harbour and, if so, why?**

  ▪ No. The safe-harbour provision should be clearly set out so there is no uncertainty as to its application, to assist with orderly transition.

▪ **Should a legal safe harbour only be required for contracts entered into before a benchmark is designated under Article 23A, and therefore any contracts entered in to after an Article 23A designation should not be in scope of safe harbour?**

  ▪ The safe-harbour provision should not be time-limited as to when a benchmark is designated under Article 23A, as the litigation risk and contractual uncertainty may arise for any contracts referencing LIBOR; for example, prior contractual commitments may result in a LIBOR contract such as lending drawdowns on long-dated loans, or swaptions exercise.

- The safe-harbour should also apply to all potential litigation arising from all legacy references to LIBOR, including ancillary references and tertiary use of LIBOR in contracts and LIBOR-linked instruments and contracts; for example, default interest provisions and interest rate hedges.

- **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?**

    - Yes. See question 4 definition of "Affected Party".

(Chapter 3 - Box 3.A: Questions)

If you consider that a legal safe harbour is needed in order to mitigate risks identified in response to the questions in chapter 2:

- **Do you have any comments on the jurisdictional issues set out above, or the proposed approach? In particular, can respondents provide any evidence of the volumes of LIBOR referencing contracts where the law of Scotland or Northern Ireland is the choice of law, that may benefit from safe harbour provisions?**

    - It should apply to contracts governed by the laws of England and Wales, and any contracts governed by the laws of Northern Ireland or Scotland, should also be included.

- **Should the scope of any legal safe harbour go beyond supervised entities making 'use' of an Article 23A benchmark in specified 'financial contracts', 'financial instruments', and 'investment funds' as defined in BMR?**

    - Yes. As the Financial Services Bill extends beyond the current scope of the UK Benchmarks Regulation ("BMR") to include any party to any contract, security or instrument that references a benchmark, to meet the policy aim of reducing contractual uncertainty and potential for litigation, the safe-harbour should apply to contracts and financial instruments where the relevant benchmark is used, and not just those that fall within the current scope of the BMR, which does not cover all product types such as loans. We advocate these products should be included and so benefit from being able to use synthetic LIBOR and a safe harbour. The safe-harbour should apply to both supervised and non-supervised entities to ensure parity of treatment to borrowers and market participants with LIBOR contracts with all financial institutions. It is key to draw attention to the fact that LIBOR use is widespread among supervised and non-supervised entities, and could extend beyond specified 'financial contracts', 'financial instruments', and 'investment funds' as defined in the BMR.

- We would note that clarity would be needed on the scope of tough legacy contracts in the upcoming FCA consultation of its powers under Article 23C, as synthetic LIBOR may only be available for a further transition period and not for the full life of a product.

- We continue to advocate for a safe-harbour provision in line with the EU/US draft safe harbours allowing protection where discretion is used to amend to an agreed replacement rate. Determination Agents and Calculation Agents are responsible for performing the calculations set out in transaction documentation, applying the interest rate provisions, making determinations required under the contract and communicating interest repayment amounts to issuers, and are therefore exposed to litigation risk from investors/parties to the contracts. Determination Agents exercising discretion when determining when to replace LIBOR in contracts and applying the industry recommended benchmark replacement (i.e., selecting a workable fallback on a unilateral basis rather than by active transition) are exposed to litigation risk.

- We would note that, at this point in time, synthetic LIBOR seems to be contemplated for GBP LIBOR and potentially for JPY LIBOR and USD LIBOR but not for other currencies.

- **Should a legal safe harbour provide for situations where a contract describes a benchmark alongside, or instead of, the express name of the benchmark in question? If so, how? Please provide examples of contract wording to illustrate your response.**

  - The safe-harbour provision should apply to all contracts that both expressly reference LIBOR, as well as contracts that describe a LIBOR benchmark provision, and/or the calculation methodology applied to them, without expressly naming the LIBOR benchmark.

- **How would we best ensure, within any legal safe harbour provisions, that parties to contracts falling in scope of the safe harbour retain the freedom to move away from referencing or relying upon a benchmark that has been designated as an Article 23A benchmark to alternative appropriate arrangements, or to terminate the contract, provided they reach consensual agreement?**

  - In the example of structured notes where the fallback trigger is only activated on LIBOR cessation, we propose the solution is to ensure synthetic LIBOR can apply and be used in such circumstances, or that LIBOR cessation is recognised where it results in application of an industry recognised risk free rate - in both cases we recommend a safe-harbour from the potential litigation risk.

In particular, how should safe harbour provisions interact with contractual fallbacks? Please provide examples of contractual wording where relevant.

In your response please provide any further views on how safe harbour provisions should be designed or scope in order to address the risks identified in responses to th e questions in Chapter 2.

- The safe-harbour should apply to all applicable parties, referred to as "Affected Parties" including: administrators, calculation/paying/determination agents, trustees, unregulated/unsupervised and regulated/supervised entities, and wholesale and retail consumers and lenders. It should bind all existing parties to a product, alongside beneficiaries to whom fiduciary duties are owed, and parties to whom rights have been transferred (e.g., transferees/assignees, and beneficiaries).

- As the Financial Services Bill extends beyond the current scope of the BMR to include any party to any contract, security or instrument that references a benchmark, to meet the policy aim of reducing contractual uncertainty and potential for litigation, the safe-harbour should apply to contracts and financial instruments where the relevant benchmark is used, and not just those that fall within the current scope of the BMR, which does not cover all product types such as loans.

- We are aware of a potential contractual interpretation issue with respect to existing references to LIBOR in contracts and whether these would be construed as being replaced by synthetic LIBOR (i.e., a benchmark labelled LIBOR, that is available in the same way as LIBOR, but calculated in a materially different way). In that context, material changes to the methodology may either, depending on the fall-back wording: (i) trigger contractual obligations, including fall-back language, or obligations to notify a change in the rate to synthetic LIBOR; or (ii) give rise to uncertainty as to whether such contractual fallbacks have been properly triggered.

- By publishing synthetic LIBOR, a rate would exist which, absent any protection from litigation, parties could use to compare against the performance of the Recognised Alternative Risk Free Rate to which they have transitioned, and bring a claim for any difference in value and consequential losses.

(Chapter 4 - Box 4.A: Questions)

- **To what extent would a 'safe harbour', as described in previous chapters, mitigate the risk of litigation against the administrator? Are there still claims that could arise against the**

administrator of an Article 23A benchmark, and if so, how would they arise and what would they include?

- A safe-harbour should provide statutory protection to the administrator for all publication, use and application of the FCA-directed synthetic LIBOR replacement rates against the risk of litigation from claims of contract frustration and force majeure, and for statutory contract continuity, as well as immunity from all related claims. A safe-harbour provision should promote market stability and mitigate litigation risk for the benefit of all market participants, customers and clients, thereby promoting smooth transition and minimising market disruption by removing litigation risk.

- **Subject to the possibility of claims arising (as above), would it be appropriate to provide for legal protection against the administrator against specific legal claims or causes of action or liabilities? If so, how should these inform the design of any legal protections for the administrator?**

  In your answer, please consider HM Treasury's position (as stated above) that any legal protections from litigation would apply when an administrator is acting under the direction of the FCA following the exercise of their powers in the BMR as amended by the Financial Services Bill and would not apply otherwise.

  - The safe-harbour should apply to the administrator consistent with all applicable parties, referred to as "Affected Parties", including also: calculation/paying/determination agents, trustees, unregulated/unsupervised and regulated/supervised entities, and wholesale and retail consumers and lenders. It should bind the administrator and all existing parties to a product, alongside beneficiaries to whom fiduciary duties are owed, and parties to whom rights have been transferred (e.g., transferees/assignees and beneficiaries).

- **Are there specific legal claims or causes of action or liabilities that should be expressly carved out of any legal protections afforded to the administrator?**

  - No. As stated above, the safe harbour protection for the administrator should be consistent as for other Affected Parties.