**Investment Company Institute response to the HM Treasury consultation on introducing a legal safe harbour to supplement amendments to the UK Benchmarks Regulation**

The Investment Company Institute, including ICI Global,[1] appreciates the opportunity to provide its response to the HM Treasury (HMT) consultation on whether a safe harbour would be a helpful legislative supplement to the amendments to the UK Benchmarks Regulation (BMR) in the proposed Financial Services Bill.[2] We understand that HMT is considering a safe harbour to reduce the risk of legal uncertainty for tough legacy contracts referencing a discontinued benchmark that the Financial Conduct Authority (FCA) would designate as critical under the amended BMR and change the benchmark's calculation methodology. Specifically, HMT is requesting feedback on a safe harbour that would both address contractual continuity for tough legacy contracts and provide contractual parties with protection from litigation if the FCA undertakes actions under the BMR.

As the trade association representing regulated funds globally,[3] ICI has a significant interest in the orderly transition from LIBOR benchmarks.

ICI's overall priorities in evaluating proposals for LIBOR benchmark transition are:

- To support proposals that provide legal certainty to market participants and minimize changes to the economic value of affected contracts;
- To promote global alignment on benchmark reform to reduce potential friction and differences in regulatory or legislative approaches to transition; and
- To promote transparency with respect to the policies under the BMR.

Given those overall priorities, we support a safe harbour overall as a tool to promote legal certainty for tough legacy contracts. While the choice of a fallback rate should remain primarily with contractual parties that are best placed to assess the specific replacement rate and ensure a smooth

[1] The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$28.5 trillion in the United States, serving more than 100 million US shareholders, and US$9.6 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in Washington, DC, London, Brussels, and Hong Kong.

[2] *See* Supporting the wind-down of critical benchmarks consultation (February 2021), *available at* https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/961317/HMT_Safe_harbour_Consultation.pdf.

[3] The term "regulated funds" includes US funds, which are comprehensively regulated under the Investment Company Act of 1940 (Investment Company Act), and non-US funds, that are organized or formed outside the US and substantively regulated to make them eligible for sale to retail investors, such as funds domiciled in the European Union and qualified under the UCITS Directive (EU Directive 2009/65/EC, as amended), Canadian investment funds subject to National Instrument 81-102, and investment funds subject to the Hong Kong Code on Unit Trusts and Mutual Funds.

contractual transition, should such fallback not exist or not be able to be triggered, the existence of a safe harbour can provide legal clarity and facilitate the continuity of the contract.

We urge the HMT to align the application of any safe harbour in the UK tough legacy solution with that in the tough legacy solutions of other jurisdictions. Without global alignment of the fundamental tenets of such solutions, there is a risk of forum shopping and regulatory arbitrage, undermining the goal of legal certainty.

We also recommend that any safe harbour be narrowly tailored to promote legal certainty without causing any unnecessary burdens. We cannot evaluate those factors, however, without knowing to which contracts the safe harbour would apply. Given the present uncertainty about which contracts will be defined as tough legacy, we recommend that HMT coordinate this consultation with the expected FCA consultation on tough legacy so that ICI and other market participants can evaluate the safe harbour as part of a holistic solution.

We discuss our response in further detail below.

*Align Tough Legacy Solutions Globally to Reduce Risk of Regulatory Arbitrage*

LIBORs are global interest rate benchmarks and, as a result, transition from one to another is a complex process involving numerous jurisdictions, regulatory regimes, and regulators. Avoiding material differences, overlaps, or gaps in coverage among the approaches to benchmark transition across the globe would accelerate the progress of market participants' operational readiness and reduce the opportunity for regulatory arbitrage or adverse market impacts.

Given these complexities, we support the HMT stating in its consultation that the scope of any safe harbour would be limited to UK-law governed contracts and financial instruments. All UK regulators empowered under the Financial Services Bill or amended BMR to take any action regarding tough legacy contracts also should clarify that the scope of the UK's tough legacy solution is limited to UK-law governed contracts. Leaving borders undefined invites forum shopping and eliminating any gray area about the application of the safe harbour will promote legal certainty.[4]

Even if the jurisdictional borders of any safe harbour are well-defined, we urge UK regulators to align global tough legacy solutions and resist drafting solutions that would lead to different outcomes for otherwise identical contracts or financial instruments under different governing laws. Ideally, two USD LIBOR notes with substantially similar terms but for their governing laws should be subject to the same criteria in every jurisdiction to determine whether those notes are within the definition of tough legacy, the timing of applying any replacement or synthetic rate to the notes, and the calculation of those rates. Misalignment of these fundamental building blocks of global tough legacy solutions has the potential to not only lead to different valuation outcomes for those otherwise identical notes but also to operational challenges for all market participants.[5] For these

[4] Consistent with promoting legal certainty, we recommend that the HMT permit any enacted safe harbour to apply to contracts entered into before the FCA would exercise its expected powers under Article 23D. Doing so would minimize any gaps in the application of the safe harbour.

[5] We recommend global alignment in the definition of tough legacy and the triggers for implementing any tough legacy solution. We specifically recommend the approach of the Alternative Reference Rate Committee (ARRC) proposed New York State legislation. Even though the differing timetables for the cessation of most USD LIBOR tenors and

reasons, we urge the UK to align the terms of its tough legacy solution (including any safe harbour within that solution) with those in other major LIBOR-using jurisdictions.

*Coordinate the Consultations for the Safe Harbour and Tough Legacy Definition*

Although we support safe harbours as useful tools in promoting legal certainty and reducing the risk of litigation, the HMT should evaluate the impact of their use on market participants, including potential benefits, costs, and changes in market participant behavior. Any measures of these impacts would depend on knowing on how narrowly or broadly the safe harbour would apply, including the number of affected parties and contracts, the value of those contracts, and the types of contracts.

With respect to LIBOR transition, the measure of impact of a safe harbour will depend on which contracts and financial instruments will be deemed to be tough legacy and subject to the safe harbour. Thus, the costs and benefits of a safe harbour would proceed in concert with how broadly or narrowly the boundaries are drawn around tough legacy contracts.

To date, there has been no final definition of tough legacy in the Financial Services Bill or in the concurrent FCA consultations.[6] Further, at this time there is no certainty whether, under the FCA's expected powers, a contractual fallback provision in a tough legacy contract would be triggered when LIBOR is discontinued or deemed non-representative, or whether the LIBOR rate in the contract would convert to synthetic LIBOR without invoking the contractual fallback provision.[7] In recent statements, the FCA indicated that it will address these issues in a future, finalised policy approach.[8] Although we believe safe harbours can be beneficial, we urge the HMT to address the scope of any safe harbour alongside the definition of tough legacy and how the FCA's

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other LIBORs and differences in countries' legislative procedures may hinder the alignment of tough legacy solutions, we urge global policymakers to align the fundamental building blocks of any tough legacy solution at the earliest opportunity.

[6] We recommend adopting the approach to defining tough legacy taken by the ARRC: contracts and financial instruments with either no fallback language for the discontinuation of LIBOR or with fallback language that depends on LIBOR. Adopting this approach would appropriately tailor the application of the replacement benchmark to only those contracts irredeemably affected by LIBOR discontinuation and prevent overreaching of regulation to already agreed-upon contractual choices while limiting the opportunity for subjectivity or need for interpretation. This approach is also self-effectuating, *i.e.*, a contractual counterparty, regulator, or authority does not need to make an additional qualitative judgment about which types of fallback language would be within scope. *See* Proposed Legislative Solution to Minimize Legal Uncertainty and Adverse Economic Impact Associated with LIBOR Transition (2020), *available at* https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC-Proposed-Legislative-Solution.pdf.

[7] In any case, we recommend that the UK regulators clarify that contracts under English law that include fallback provisions with a non-representativeness trigger, such as under the ISDA Supplement and Protocol, should proceed pursuant to their fallback provisions when the contract's benchmark rate is deemed non-representative or discontinued. *See* ISDA 2020 IBOR Fallbacks Protocol (Oct. 23, 2020), *available at* http://assets.isda.org/media/3062e7b4/08268161-pdf/?_zs=rHJ4P1&_zl=FEa16.

[8] *See, e.g.,* Consultation on proposed policy with respect to the exercise of the FCA's powers under new Article 23D (November 2020), Paragraph 2.8, *available at* https://www.fca.org.uk/publication/policy/consultation-exercise-fca-powers-new-article-23d.pdf.

expected powers would interact with any safe harbours. Any continued uncertainty surrounding these fundamental issues will extend to any safe harbour as well, undermining legal certainty.