

CRITICAL BENCHMARKS (REFERENCES AND ADMINISTRATORS' LIABILITY) BILL

EUROPEAN CONVENTION ON HUMAN RIGHTS

ECHR MEMORANDUM FOR THE BILL AS INTRODUCED IN THE HOUSE OF COMMONS

1. This memorandum addresses issues arising under the European Convention on Human Rights ("ECHR") in relation to the Critical Benchmarks (References and Administrators' Liability) Bill 2021 (the "Bill"). The memorandum has been prepared by HM Treasury.
2. Lords Agnew of Oulton, Minister of State at HM Treasury, has made a statement under section 19(1)(a) of the Human Rights Act 1998 that, in his view, the provisions of the Bill are compatible with the ECHR rights.
3. LIBOR is an internationally available and systemically important critical benchmark which measures the average cost at which financial institutions lend to each other in the unsecured, wholesale market. Since 2014 the Financial Stability Board (the "FSB") has recommended a long-term transition away from LIBOR to use of alternative "risk free rates". In 2017, the FCA secured voluntary agreement from the LIBOR panel banks to continue making contributions to the rate until the end of 2021. In March 2021, LIBOR's administrator confirmed its intention to cease publication of all Sterling, Japanese Yen, Euro and Swiss Franc LIBOR settings, and two US Dollar LIBOR settings at the end of 2021. The FCA confirmed that, unless it exercises the powers available to it under the BMR, these LIBOR settings will cease to be published at the end of 2021. The remaining five USD LIBOR settings will continue to be published based on panel bank submissions until end-June 2023.
4. Provision was made within the Financial Services Act 2021 (the "FS Act") to amend the Benchmarks Regulation (the "BMR")¹ and provide the FCA with enhanced powers to oversee the orderly wind-down of critical benchmarks in order to prevent their sudden cessation. LIBOR is currently the only benchmark that is designated as a critical benchmark under the BMR. These include a power for the FCA to designate a critical benchmark under the new Article 23A of the BMR if it considers that the benchmark is not representative of the market or economic reality that it is intended to measure, or that its representativeness is at risk. When a benchmark is designated under Article 23A, the FCA has powers under Article 23D of the BMR to require it to be provided using alternative input data and methodology, referred to as a "synthetic" methodology. The FCA is able, under Article 21(3) to compel the administrator of a benchmark to continue publishing it in this form for up to 10 years. This mechanism for the provision of a "synthetic" benchmark is intended to (i) assist parties to contracts that reference LIBOR but are unable to transition their contracts to reference an alternative interest rate, and (ii) reduce the risk of significant and adverse effect on market integrity, financial stability, consumers, the real economy, or the financing of households and businesses in the United Kingdom.

¹ The Benchmarks Regulation is Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds (Regulation EU 2016/1011) as amended and retained in domestic law pursuant to the EU (Withdrawal) Act 2018.

5. The measures in this Bill are intended to operate in conjunction with the revisions to the BMR contained in the FS Act by providing legal certainty as to how references to benchmarks in contracts and other arrangements should be interpreted once the FCA has designated a benchmark under Article 23A. The effect of these measures raise ECHR issues, in particular Article 1 of Protocol 1 of the ECHR (“A1P1”) which extends not just to full “deprivation” of possessions but to control of their use. The rights under A1P1 are not absolute. Interference may be justified and in assessing whether there has been a breach of A1P1 it is well established that contracting States have a wide margin of appreciation in balancing property rights against the wider public interest. These measures also potentially engage Article 6(1) of the ECHR.
6. HM Treasury has taken the ECHR rights into account in preparing this Bill, including the relevant safeguards and considers that the Bill is a justified and a proportionate addition to ensuring the orderly wind-down of an Article 23A designated benchmark.

Wind-down of Benchmarks – background and summary of provision made by this Bill

7. The FS Act amended the BMR to provide for the designation of a benchmark under Article 23A and its methodology change under Article 23D, in order to prevent the abrupt cessation of the benchmark and support its orderly wind-down. However, following introduction of the FS Bill there was widespread industry concern that additional legislation was required to provide clarity that references to a benchmark in a contract or other arrangement would include the benchmark once designated under Article 23A. Most pressingly, industry was concerned that references to LIBOR should include LIBOR following its expected designation at the end of 2021 and during its on-going publication by the IBA during the wind-down process.
8. Clause 1 of this Bill makes express provision that reference to a benchmark in a contract is treated as including the same benchmark when it becomes an Article 23A benchmark and when a new methodology is imposed under Article 23D of the BMR. The Bill also provides that the contract is to be treated as having always provided for the reference to have this meaning.
9. Clause 2 of this Bill provides a limited immunity from liability for the administrator of an Article 23A benchmark, where it calculates and publishes the benchmark in accordance with requirements imposed by or under Article 23D of the BMR.
10. Clause 1 engages A1P1. It allows for the interference with the property rights of parties to contracts or other arrangements that reference an Article 23A designated benchmark (the “possessions” being enforceable rights under the contract or other arrangement).² It is considered that an interference of this nature is likely to amount to a “control of use”. Clause 2 potentially engages A1P1, as it provides that the administrator of an Article 23A benchmark is not liable for damages in specified limited circumstances.
11. Interference with A1P1 rights is only lawful if it is in the public interest and subject to the conditions provided by law. The European Court of Human Rights (ECtHR) has applied a “fair balance” test to considerations as to whether the interference is lawful. Any interference must

² A1P1 does not guarantee a right to acquire property. However, enforceable claims under a contract have been found to constitute possession for the purposes of A1P1: see *Wilson v. First County Trust Ltd* (no.2 – 2004 1 AC 816 (L Nicholls at para. 39).

not be arbitrary, must be designed to achieve a proper aim, must use proportionate means to achieve that aim and must strike a proper balance between the interests of the person affected and the wider public interest in the interference. HM Treasury has considered each of these aspects of legitimate interference along with the rights of those affected in producing the provisions within this Bill.

12. Both clauses might also appear to engage Article 6(1). HM Treasury considers that Article 6(1) is not in fact engaged, for the reasons set out in this memorandum.

Clause 1 – References to Article 23A benchmarks in contracts or other arrangements

A1P1

Effect on the A1P1 rights of parties to contracts and other arrangements which refer to an Article 23A designated benchmark

13. Clause 1 provides that a reference to a benchmark in a contract is to be treated as having always included that benchmark in its form as an Article 23A benchmark under the BMR to include when the FCA has exercised its powers to impose a new methodology under Article 23D (to include on-going methodology changes), until such time as the benchmark is fully wound-down. This process can last for up to 10 years.
14. This will affect parties' A1P1 rights as follows: (i) with prospective effect because it will ensure that, except where the contract/arrangement expressly provides to the contrary, sums due under the contract/arrangement are calculated by reference to the synthetic rate, preventing a party from claiming that this is not what the contract provides for; and (ii) by providing on a formally retrospective basis that the contract has always provided for the reference to the benchmark to have this meaning, which will prevent parties claiming a contract is frustrated or has been materially changed because the benchmark in its designated form is different from what the parties contemplated when they entered into the contract.

Legitimate aim

15. HM Treasury considers that the policy aim of preventing widespread contractual uncertainty, disputes and litigation, including frustration of contract and claims of termination of contract on the grounds that a *material adverse change* clause is triggered, caused either by ambiguity as to whether a designated benchmark should continue to be referenced in a contract or an unwillingness of parties to accept a reference in their contract to a benchmark in its Article 23A designated form, is a 'legitimate aim' for the purposes of interference in parties' A1P1 rights.
16. Critical benchmarks are recognised as being highly important in the functioning of the wider economy, so that the potential for contractual disputes and litigation could cause wide-spread financial instability, adversely affect the real economy and cause losses to consumers and investors. As such we consider that the risk of such interference falls within the economic sphere for which States have a wide margin of appreciation. In general, the ECtHR will only question a legitimate aim in this sphere if it is "manifestly without reasonable foundation" which we do not consider to be the case in this instance.

Is the interference proportionate?

17. Any interference with A1P1 rights must be no more than is necessary to achieve the policy intention. HM Treasury has considered alternatives, including relying solely on the wind-down provisions in the FS Act. This is against a backdrop of a market-led approach to the wind-down of LIBOR, with express encouragement from the Bank of England and FCA, for parties to move contracts away from referencing LIBOR to an alternative rate, and recommendations made by the FSB on the need to transition away from LIBOR since 2014.
18. There is a real concern that, absent the provisions in this Bill, parties may be uncertain or unwilling to treat a reference to LIBOR as a reference to LIBOR in its synthetic form. Either of these outcomes risks undermining the policy objective and causing contractual disputes and litigation. This in turn risks causing widespread market uncertainty and disruption.
19. HM Treasury has engaged with stakeholders formally, by way of public consultation in February of this year, and informally and there is widespread support for legislation to provide a more robust approach to “continuity of contract” between LIBOR in its current form and the wind-down of the benchmark under Article 23A of the BMR.
20. As outlined at paragraph [3] above, parties have since 2017 been encouraged to actively transition contracts away from referencing LIBOR to referencing an alternative rate. The Bill, operating in conjunction with the FS Act, will largely apply to contracts that have been unable in the preceding years to transition from LIBOR to an alternative rate due to constraints within their contracts - referred to as “tough legacy” contracts. The FCA is currently consulting on the types of contract that will qualify as “tough legacy” under the BMR and is expected to provide guidance later in 2021.
21. The Bill is also designed to operate in a way that does not cut across or interfere with contractual “fallback” provisions that would allow the contract to transition away from referencing LIBOR to reference something other than the benchmark.
22. Under the FS Act, the publication of synthetic LIBOR is time limited to a maximum of 10 years, subject to annual review by the FCA every 12 months to determine whether the criteria for continued compulsion are met and whether it is still reasonable to continue publication in public law terms.
23. HM Treasury therefore considers that the proposal strikes a fair balance between the interests of persons affected and the wider public interest.

[Article 6: the right to a fair hearing]

24. [Article 23FA might appear to engage Article 6(1).]

Nature of interference

25. Articles 23FA(1) and (2) make substantive provision designed to prevent claimants alleging that the reference to a designated benchmark, such as LIBOR, is a breach of contract. The formally retrospective provision in Article 23FA(5) is intended to prevent parties from claiming their contract is frustrated or that a material adverse change clause is triggered due to an Article 23A designation or Article 23D methodology change. It is possible that parties may

argue that the effect of this provision is to remove their right to a fair and public hearing and that this therefore breaches Article 6(1) of ECHR.

Justification

26. The provisions in Article 23FA will mean that there is no basis in domestic law for parties to argue that the designation of a benchmark or imposition of a new methodology constitutes a material change to a contract, or has resulted in the contract being breached or frustrated. Article 6(1) is not engaged because its applicability depends upon the existence of a substantive dispute which can be said, at least on arguable grounds, to exist in domestic law. Article 6 does not control the content of a state's substantive domestic law.
27. It is the view of HM Treasury that there are currently no claims in existence that would be affected by this provision and that Article 23FA is intended to remove any substantive contractual rights that might be argued to exist in relation to the FCA's exercise of its powers under the Article 23A designation process or Article 23D methodology change.

Clause 2 – Liability of the administrator of an Article 23A benchmark

A1P1

Effect on the A1P1 rights of parties to contracts and other arrangements to bring a claim against the benchmark administrator

28. Clause 2 provides a limited form of immunity from litigation for the benchmark administrator. It could be argued that the immunity interferes with the rights of a party to bring a claim against the administrator in relation to its production and publication of the synthetic benchmark. However, given that the immunity is extremely limited in scope – applying to cases concerning (i) action or inaction that the administrator is required to take by virtue of Article 23D and (ii) the administrator's publication of the benchmark in its synthetic form, both of which HM Treasury considers would have a low prospect of success if brought – it is debateable whether there is any interference. The immunity does not protect the administrator to the extent that it exercises any discretion regarding the calculation and production of the benchmark or the time or manner of its publication, and therefore parties will still be able to bring claims in this respect.

Legitimate Aim

29. To the extent that there could be an interference in a person's rights for the purpose of A1P1, the policy objective in relation to this clause is to protect the benchmark administrator from claims made as a result of it publishing a synthetic version of a designated benchmark. The stakeholders have raised concerns that the administrator is at risk of being cited as a defendant in claims relating to the production and publication of a synthetic benchmark, and that this risk may lead to administrators being unwilling to produce and publish the synthetic benchmark. In particular, stakeholders have raised the risk of claims related to allegations of misstatement or misrepresentation, or negligence (with the claimant seeking to argue that the administrator owes a duty of care to market users and that this will be breached by the publication of a benchmark, such as LIBOR, in synthetic form).
30. It is the view of HM Treasury that the risk of successful claims against the benchmark administrator are low because it would have various defences available to it. When the FCA exercises its powers under Article 23D, the administrator will be under a statutory obligation

to publish the benchmark in a synthetic form. It is therefore legitimate for the Government to seek to provide a limited protection to the administrator from claims which might be brought in relation to its performance of those statutory obligations. The protection will be limited to claims arising from action or inaction that the administrator is required to take by or under Article 23D and to publication of the benchmark in its synthetic form. It will not extend to any discretion exercised by the administrator in its production of the benchmark or as to the time or manner of publication.

Is the interference proportionate?

31. Any limited interference resulting from this provision is proportionate. The provision only applies to the extent that the administrator complies with requirements imposed on it by or under Article 23D of the BMR regarding the calculation of the Article 23A benchmark, and for publishing the rate in this form. It is not reasonable for the administrator to be subject to claims which arise solely due to its compliance with statutory requirements, and it is therefore appropriate to make this provision which will avoid the administrator being subject to the cost of defending them.
32. The provision does not provide protection to the administrator for the exercise of discretion regarding the production of the benchmark or the time or manner of its publication, where HM Treasury's view is that it is right for claimants to be able to bring claims and for these to be determined by the court.
33. We consider that the proposal strikes a fair balance between the interests of potential claimants and the wider public interest of ensuring that the administrator of an Article 23A benchmark is not subjected to unreasonable and vexatious claims and continues to publish the benchmark in its designated form.

Article 6: the right to a fair hearing

34. Clause 2 might appear to engage Article 6(1) of ECHR on the basis that the benchmark administrator cannot be subject to claims for damages for any action or inaction required of it by the FCA under Article 23D of the BMR. However, this provision is narrowly constructed to protect the administrator from claims only to the extent it performs obligations imposed by statute, or for the act of publishing the benchmark in the form it is required to be produced. It does not protect the benchmark administrator to the extent that it exercises a discretion or permission conferred on it in relation to the production of the benchmark. It is therefore HM Treasury's view that, given the low likelihood that a claim covered by this immunity could succeed, it does not prevent real disputes from being determined and accordingly Article 6(1) is not engaged.

Her Majesty's Treasury

September 2021