European Financial
Markets Lawyers Group

- THE VICE-CHAIRMAN –

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Mr. Tilman Lueder
Head of Securities Markets
Directorate-General for Financial Stability
Financial Services and Capital Markets Union
European Commission
1049 Bruxelles
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REVIEW OF THE EU BENCHMARK REGULATION AND RELATED ISSUES / CRITICAL BENCHMARKS

Dear Mr. Lueder,

The European Financial Markets Lawyers Group (EFMLG[1]) has previously expressed its concerns on certain key legal issues raised by the transition of critical benchmarks, notably on transitioning to new Risk Free Rates, as covered by the EU Regulation 2016/1011 on benchmarks in financial instruments and financial contracts (the "Benchmarks Regulation"), as highlighted in the last letter addressed to the European Commission on 16 October 2018. Private and public sectors working groups made of bankers, lawyers, professional associations and the authorities have in the past years reflected extensively on IBORS transition.

In light of the European Commission - public consultation document review of the EU Benchmark Regulation, the members of the EFMLG take again this opportunity to tackle hereafter some critical issues in the text, with particular focus on the Change of methodology and continuity of contracts; Strengthening the Panel of Critical Benchmarks; Orderly Cessation of a Critical Benchmark; Authorisation and Registration; Continued use of non-compliant benchmarks; Benchmark Statement; Non EEA Benchmark and Equivalence Recognition and Endorsement.

The EFMLG is writing to urge you to consider these key concerns, some of which could be addressed in the report the Commission is due to summit to the European Parliament and to the EU Council by the first quarter of 2020.

Identified issues/concerns raised by the termination or modification of the benchmarks.

1- Change of methodology and continuity of contracts

The EFMLG will start with the observation that it would be very useful for a competent authority to have broader powers to require the administrator to change the methodology of a critical benchmark.

[1] The European Financial Market Lawyers Group (EFMLG) is a group of senior legal experts from the EU banking sector dedicated to making analysis and undertaking initiatives intended to foster the harmonization of laws and market practices and facilitate the integration of financial markets in Europe. The members of the Group are selected, on the basis of their personal experience, amongst lawyers of major credit institutions based in the EU active in the European financial markets.

The power to compel a change in methodology of a critical benchmark could be an important safeguard against a critical benchmark suddenly ceasing to exist or becoming prohibited from use.

We therefore support the introduction of an obligation for the administrator to change its methodology, so that the benchmark becomes representative for the underlying market or economic reality and the benchmark does not immediately cease to exist. This could contribute to a smooth transition away from a critical benchmark towards another new (nearly) risk-free critical benchmark.

It is of the utmost importance to ensure legal certainty and contract continuity that the Benchmark Regulation indicates clearly that the underlying interest measured by the benchmarks remains the same after the relevant modification of a benchmark methodology. The corresponding provisions that regulate this issue must be established in such a way that it is stated that any modification – possibly required directly by the authority - is deemed to be made on the basis that the benchmark so modified continues to measure the same underlying interest. Therefore, any potential amendment in the benchmark methodology required by the relevant competent authority should implicitly mean that the benchmark continues measuring the same underlying reality. By imposing such obligation, the Benchmark Regulation would (i) clarify the need of carrying out the relevant assessment before imposing any changes in the methodology; (ii) reduce the risk of contract frustration, since if it is formally stated by the public authority that the benchmark continues to measure the same underlying interest, the risk of contract frustration linked to that change in the methodology would be lower.

2- Strengthening the Panel of Critical Benchmarks

Indeed corrective powers should apply to critical benchmarks, our better thoughts below:

- The power of competent authorities to oblige the administrator to change its methodology should be confined to situations in which a critical benchmark could potentially cease to exist due to no longer reflecting the underlying market or economic reality.

- Such powers of competent authorities should also be limited to exceptional circumstances, and leave the correction in the first place to the administrator of the benchmark to allow the administrator to change the methodology under Article 11(4) of the Benchmark Regulation.

- Although we can generally assume at first glance that the procedure to be followed for the change of the methodology of a critical benchmark that is based on submissions by contributors already contains quite some checks and balances. Eventually, Article 23(4), (5) and (6)(a), (b) and (c) Benchmark Regulation are to ensure sufficient contributions and therewith the representativeness of the critical benchmark. As a final step Article 23(6)(d) Benchmark Regulation comes into play to enable the competent authority to require a change of methodology or a change to the code of conduct or of any of the other rules of the critical benchmark. However, as developed below, strengthening the panel of contributors to benchmarks might be desirable to improve the robustness, reliability or representativeness of the benchmark as suggested hereafter.

- As far as critical benchmarks are concerned, although from a legal point of view the functioning of the Euribor has been validated and complies with all Benchmark Regulation requirements, the panel of benchmarks (specially, Euribor) should be strengthened, to increase its number, on a permanent basis, and improve the geographical diversity of its member entities. It is widely known that in recent years there has been a decrease in the number of panel members (since 2012, 26 banks have left this panel, which currently has 18 members). In this regard, it should be noted that situation varies among countries: there are

countries such as Spain and France, which have 4 and 5 entities in this panel, respectively whereas in contrast, other countries, whose size and volume of transactions are very relevant, have only one or two representatives in the panel.

As a matter of fact, if persuasion mechanisms have been used for the incorporation of new entities, they have not been successful. Therefore, consideration could be made to implement new formulas, other than those provided for in Article 23 of Benchmark Regulation (Mandatory Contribution to a Critical Benchmark), to incorporate on a permanent basis new entities into the panel, thus achieving a more stable and representative panel and ensure that the diversity of the euro money market is adequately reflected, thereby making Euribor a more efficient and robust benchmark and strengthening financial stability. The elements on which the obligation of credit institutions to belong to a benchmark panel of contributors could be supported, should be: their active participation in the euro money market, the relevant use, in terms of volume, made by the different entities of a benchmark (derivatives, financing or other), as well as their size and technical means.

3- Orderly Cessation of a Critical Benchmark

In the discussions we had within the EFMLG, strong arguments were put forward that benchmark cessation plans should be approved by national competent regulators. On this particular aspect of the reform – as underlined under Question 4 of the consultation - we took the view that such plans should be approved by the national competent regulators, but would suggest that these national competent regulators align on the criteria used for the examination of such plans.

4- Authorisation and Registration

The EFMLG would consider that currently it is very unclear whether a competent authority has the powers to withdraw or suspend the authorisation or registration of an administrator in respect of one or more benchmarks only.

As a matter of fact it is unclear, because:

- Under the current set-up of Benchmark Regulation it is most likely that competent authorities can only suspend or withdraw the authorization or registration at the level of the administrator of the benchmarks and not at the level of the benchmarks administered.

- We agree with the difficulties of this approach as mentioned in the consultation document and welcomes the suggested change in the set-up to enable the competent authorities to exercise these powers at the level of the benchmarks.

- We would recommend that the ESMA Register should specify for EEA administrators which benchmarks they administer and specify the status of the benchmarks under the Benchmark Regulation to ensure full transparency to users. We would also be in favor of including whether an application is pending or has been denied.

5- Continued use of non-compliant benchmarks

The EFMLG would also consider as an echo to Question 8 of the consultation that the current powers of national competent authorities ("NCAs") to allow the continued provision and use in existing contracts for a benchmark for which the authorisation has been suspended are not sufficient for the following reasons:

- In the context of competent authorities' powers in respect of granting authorisation to the administrator of a benchmark or withdrawal thereof, those authorities should be granted with sufficient powers to accompany the measures to be taken, in particular in the case of the withdrawal of an authorisation as to the implications it would have on existing contracts ("legacy"). Notably we would – in that context -: stress the importance of the possibility of continuation of benchmarks provided by administrators whose authorization or registration was suspended, since these benchmarks could potentially be used in many financial instruments and financial contracts.

In our views also, the powers of competent authorities to permit continued use of a benchmark when cessation of that benchmark would result in contract frustration are neither totally appropriate nor sufficiently effective. They will be appropriate provided they apply when needed.

- We support the possibilities of continued use of benchmarks for legacy contracts as it is in the general interest to be able to smoothly transition away from benchmarks that will cease to exist to alternative benchmarks.

- We would like to stress that the mere fact that competent authorities have powers to permit continued use does not automatically imply that they will indeed use these powers.

- We would certainly invite the competent authorities and/or ESMA to clarify that they should not be too reluctant to apply these powers and actively ensure a smooth transition from benchmarks that cease to exist to alternative benchmarks.

In this regard, in the event that the competent authority has declared that a particular benchmark does not meet the requirements of Benchmark Regulation (i.e., is deemed "non BMR-compliant"), users should be allowed to continue to use such benchmark in certain circumstances and avoid the automatic cessation of such benchmark, in order to ensure the continuity of the contracts using such benchmark as a reference. This permitted use could be established either for users of certain products or transactions that may prove impossible to modify, or for a sufficient period of time allowing its replacement by another benchmark.

National Competent Authorities should have on a case by case basis the possibility of allowing the continued provision and use of a non-compliant benchmark for legacy contracts also where the authorisation or registration is withdrawn.

As it could be very difficult to anticipate a list of scenarios where the benchmarks should not be maintained and, it might not be possible to foresee the market circumstances that will occur if such scenarios happen. Therefore, we suggest that, as a general rule, the permission to use the benchmark should be maintained and, if there is a negative scenario where it does make no sense to maintain a benchmark, then, the authorities should be entitled to limit the permission on a case by case basis.

6- Benchmark Statement

If any change is introduced in a critical benchmark, the administrator of the relevant benchmark should expressly state whether or not in his opinion the identity of the benchmark has been altered and whether or not such benchmark continues to measure the same economic reality. Likewise, this statement should be accompanied by a declaration of the supervisory authority approving the change, within the authorization, expressly stating whether or not the identity of such critical benchmark has been altered and whether or not such benchmark continues to measure the same economic reality.

7- Non-EEA Benchmarks

Globally speaking and as a fact, the scope of the Benchmark Regulation is much broader than any other benchmark regulation around the world. This is potentially a source of uncertainties and does not allow and effective equivalence system.

More specifically, as regards to potential issues relating to FX forwards market, our global view would be that it could potentially affect very much the concerned businesses.

Additionally:

- certainly lot of impact of currencies which are administered by non-central banks
- in order to reduce risk, EU Regulators should reach out to these administrators to urge these administrators to ensure that they comply with Benchmark Regulation. Where equivalence is possible this should be granted.
- support changes in the Benchmark Regulation to exclude FX forward contracts entered into for the purpose of reducing risk due to commercial activity or treasury financing of non-financial counterparties.
- point out that if FX forwards cannot be traded between financial counterparties, this would have detrimental impact on the EU economy as well. A wider exemption to protect the economic interests of Europe should be considered.

8- Equivalence Recognition and Endorsement

On this field of paramount importance, the EFMLG considers below the improvements to be envisaged.

As a reminder, Recital 40 of the Benchmark Regulation stresses the importance of proportionality and ensuring that an excessive administrative burden should not be placed on administrators of benchmarks whose cessation causes less threat to the wider financial system.

Worth noting as well that the IOSCO Principles underline similar views on ensuring the proportionality of the application of such Principles to the size and risks of each benchmark and administrator.

We would therefore strongly support relevant amendments be made to the existing application of the Benchmark Regulation to third country administrators. In particular, we recommend lightening the burden of the requirements, accountability and liability put on those representatives and entities under Article 32.3 and 33.1; exempt non-significant benchmarks to the Benchmark Regulation; easing the process for transparency as regards to the criteria for granting equivalence to a jurisdiction's regulatory framework, enabling a smoother equivalence decision in the end; rethink the requirements under Article 33.1 by erasing the idea of a "objective reason ...." for potential applicants for endorsement.

Additionally, it will be crucial that EU27 supervised entities are able to continue using LIBOR under the EU Benchmark Regulation in the event that LIBOR becomes a third country benchmark from an EU27 perspective: EFMLG reckons there is a need for positive equivalence assessment for the UK situation.

Finally, our other key messages would be:

- EU governmental bodies should raise awareness amongst third country administrators and make sure that as much as possible third country administrators become Benchmark Regulation compliant. Where possible equivalence should be granted.

- Alternatively, the EU could consider delaying the third country benchmark deadline for those benchmarks which are vital for the economy of the EU, e.g. FX and interest rate benchmarks as well as certain commodities.

- Suggest being more lenient in order to allow third country benchmarks to be recognized even if the administrator does not have a legal representative in the Member State of reference, but would itself comply with Benchmark Regulation.

We appreciate your consideration for what we believe are messages of paramount importance.

The EFMLG, on our side, stays at your disposal for any further assistance or support you may determine on the matter. Please kindly keep the EFMLG informed as to the better views raised above.

Yours sincerely,

Fernando Conlledo

Vice-Chairman