ISDA, ASIFMA, EACT, EMTA, FIA, GFXD Update EU Benchmarks Regulation Review Recommendations

NEW YORK, August 11, 2022 – The International Swaps and Derivatives Association, Inc. (ISDA), the Asia Securities Industry and Financial Markets Association (ASIFMA), the European Association of Corporate Treasurers (EACT), EMTA, Inc., the Futures Industry Association (FIA) and the Global Foreign Exchange Division (GFXD) of the Global Financial Markets Association (GFMA) have published an updated set of recommendations in response to the European Commission's (EC) latest consultation on reform of the EU Benchmarks Regulation (BMR).

Originally published in 2020, the industry recommendations have been developed to maintain the intended protections of the BMR but reduce the potential for uncertainty and disruption, as well as avoid putting EU investors at a competitive disadvantage to non-EU entities. In May 2022, the EC launched a targeted consultation on the third-country benchmark regime under the BMR, with responses due by August 12.

The industry recommendations would narrow the scope of the BMR for both EU and third-country benchmarks. An estimated three million benchmarks are in use globally, the majority of which pose no systemic risk. However, a general prohibition on use within the BMR means none of these benchmarks can be used by EU investors unless they comply with the regulation. A complex, costly and burdensome third-country benchmark regime has led to concerns that many overseas benchmarks are unlikely to qualify, barring them from use in the EU after the end of the transition period on December 31, 2023.

The prohibition of potentially large numbers of benchmarks would result in EU end users being unable to manage the risks that arise from their business activities or make informed investment decisions, the associations say. Given no other jurisdictions have implemented similarly expansive benchmark regimes, the current regulations also disadvantage EU retail and institutional investors.

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To prevent this, the associations recommend reversing the general prohibition on use of third-country benchmarks, enabling benchmarks to be used in the EU unless specifically prohibited. In addition, it is recommended that only those benchmarks deemed to pose a systemic threat to the EU should be subject to the full scope of the regulation. As part of the proposals, a voluntary scheme would be introduced to allow all other benchmarks meeting the requirements to be labelled as BMR-compliant, acting as an incentive for administrators to meet EU standards on governance and transparency.

In alignment with the approach taken for the transition of ‘tough legacy’ LIBOR positions, the associations also recommend replacing the current form of prohibition of use in new and legacy transactions with a ‘no new flow’ proposal. This would permit the ongoing use of a systemically important benchmark to manage existing exposures, thereby reducing the risk posed by the benchmark ceasing to qualify under the BMR. End users would then be able to reduce their exposure by entering into equal and offsetting trades or transition to a new benchmark by means of novations and basis swaps.

“The BMR’s third-country benchmark regime could result in a large number of benchmarks becoming unavailable to users in the EU, even though they may need them to make investments, manage risk or calculate payments. With just over 16 months to go until the end of the transition period, our updated recommendations aim to ensure the most rigorous safeguards apply to benchmarks that pose systemic risk to the EU, without preventing end users from accessing all of the non-systemic benchmarks they need to manage their risks and compete in a global market. Without meaningful reform, it will be necessary to further extend the transition period to the end of 2025,” said Scott O’Malia, ISDA’s Chief Executive.

“The potential impact of the third-country regime is disproportionate in Asia given the high level of capital investment across the region from European institutional investors and corporates that also need to trade products that reference third-country benchmarks via their domestic banks to hedge their exposures. Not only will this adversely impact the competitiveness of European supervised entities and these investors, which are important to economic growth in Europe, but it will also have a detrimental effect on Asian local markets as liquidity pools fragment and costs of hedging start to increase. Our recommendations are focused on mitigating the potentially significant disruption once the transition period ends in January 2023,” said Alice Law, CEO of ASIFMA.

“The risk surrounding the implementation of the third country regime and the potential prohibition of a large number of third-country benchmarks in the EU is disproportionate to any potential benefits first envisioned when the BMR entered into force. It is essential for corporate treasurers to maintain access to the variety of indices, notably FX spot rates, which are used on a daily basis by European businesses operating in the real economy to properly manage their commercial risks, ultimately making financial markets more stable. To this end, the EACT endorses the changes suggested in this paper, which strike a good balance between upholding the BMR’s high standards for the most significant benchmarks while preserving choice for end-users and preventing market concentration,” said François Masquelier, Chair of the EACT.

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“EMTA strongly supports the proposed adjustments to the BMR, which would reduce systemic risk in the administration of benchmarks and preserve EU investor access to current FX spot rates for use in currency hedging transactions that are critical to investment in emerging market economies,” said Leslie Payton Jacobs, Managing Director and Senior Counsel at EMTA.

“It is critical for EU market participants and investors to be able to continue to use third-country benchmarks for risk management, investment and other purposes. As the end of the transition period is fast approaching, the updated recommendations represent a needed adjustment to today’s BMR regime, allowing global competitiveness of EU markets while continuing to protect EU investors by adopting a proportionate, balanced and practical regulatory regime for use of benchmarks in Europe. We also call on the EC to extend the transition period for the third-country benchmarks regime until the end of 2025 to provide sufficient time for the reforms to be implemented,” said Walt Lukken, FIA President and CEO.

“The concerns we highlighted in June 2020 continue to persist. Our recent outreach to third-country benchmark administrators of key spot FX rates in impacted jurisdictions, which are used extensively by buy-side investors, indicates that they are no closer to being authorized for use in the EU when the transition period ends on December 31, 2023. There is no incentive for third-country administrators of benchmarks that present no systemic risk in the EU to incur the overhead and burden of complying with the BMR third-country regime. Given the global nature of how the FX market is traded, the potential disruption to both European users of these benchmarks and the global FX market is significant. Through the current review process, we have made proposals that will continue to protect market integrity, financial stability and the real economy, while still enabling end-users to manage their risk through being able to access third-country benchmarks that do not pose a systemic risk to the EU,” said James Kemp, Managing Director of GFXD.

The full set of recommendations includes:

- Allowing benchmarks to be used in the EU unless specifically prohibited (ie, a reversal of the current general prohibition of benchmarks unless specifically authorized).
- Providing powers to the EC to mandate compliance for EU and third-country ‘systemic’ benchmarks that are most systemically important to investors in the EU where proportionate and in the public interest to do so.
- Allowing third-country administrators to qualify via authorization, equivalence, or reformed endorsement or recognition processes.
- Exempting all other EU and third-country benchmarks from mandatory designation.
- Exempting public policy benchmarks (eg, FX rates used in non-deliverable forwards and certain interest rate swaps) and regulated data benchmarks.
- Providing a voluntary labelling regime to allow administrators to comply with the BMR and market their benchmarks as BMR-compliant.

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- Providing regulators with the power to prohibit the acquisition of new exposure to strategic benchmarks that fail to comply with the BMR, but, in alignment with international 'tough legacy' powers for LIBOR, permitting the use of such benchmarks for managing or reducing legacy positions (including undertaking new transactions for such purposes).
- Providing end users with greatly enhanced visibility on whether third-country benchmarks have qualified (or been disqualified) for use under the regime via a more usable European Securities and Markets Authority register for benchmark administrators and third-country benchmarks.

The full version of the recommendations and accompanying analysis is available here.

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About ISDA
Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 990 member institutions from 78 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.

About ASIFMA
ASIFMA is an independent, regional trade association comprising a diverse range of over 160 leading financial institutions from both the buy and sell side, including banks, asset managers, law firms and market infrastructure service providers. Together, we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia. ASIFMA advocates stable, competitive and efficient Asian capital markets that are necessary to support the region's economic growth. We drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice. Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the GFMA alliance with SIFMA in the US and AFME in Europe, ASIFMA also provides insights on global best practices and standards to benefit the region.

About EACT
Founded in 2002, The EACT (The European Association of Corporate Treasurers) brings together 14 000 treasury professionals active in 23 countries in non-financial companies and working for over 6500 individual companies. The EACT is the voice of this community in Europe and beyond and strives to represent the real economy and end-users of financial services.

About EMTA
Founded in 1990, and currently with over 170 members worldwide, EMTA (formerly, the Emerging Markets Traders Association) is a not-for-profit corporation dedicated to promoting the orderly development of fair, efficient and transparent trading markets for Emerging Markets instruments, and the integration of the Emerging Markets into the global financial marketplace. EMTA's website is located at www.emta.org.

About FIA
FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C.
FIA's mission is to:

➢ Support open, transparent and competitive markets,
➢ Protect and enhance the integrity of the financial system, and
➢ Promote high standards of professional conduct.

As the leading global trade association for the futures, options and centrally cleared derivatives markets, FIA represents all sectors of the industry, including clearing firms, exchanges, clearing houses, trading firms and commodities specialists from about 50 countries, as well as technology vendors, law firms, and other industry service providers.

About GFXD
Global Foreign Exchange Division (GFXD) was formed in co-operation with the Association for Financial Markets in Europe (AFME), the Securities Industry and Financial Markets Association (SIFMA) and the Asia Securities Industry and Financial Markets Association (ASIFMA). Its members comprise 24 global foreign exchange (FX) market participants24, collectively representing the majority of the FX inter-dealer market25. Both the GFXD and its members are committed to ensuring a robust, open and fair marketplace and welcome the opportunity for continued dialogue with global regulators.