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15 April 2020

Re: Review of the EU Benchmark Regulation (BMR), Inception Impact Assessment

Dear Mr. Lueder,

The Asia Securities Industry & Financial Markets Association ("ASIFMA") and the Global Foreign Exchange Division ("GFXD") of the Global Financial Markets Association welcomes the opportunity to provide comments to the European Commission Inception Impact Assessment on the Review of the EU Benchmark Regulation (the Impact Assessment).

ASIFMA is an independent, regional trade association with over 100 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, professional service firms, law firms and market infrastructure service providers. It harnesses the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia.

ASIFMA advocates stable, innovative, competitive and efficient Asian capital markets that are necessary to support the region's economic growth. It drives consensus, advocates solutions and effects change around key issues through the collective strength and clarity of one industry voice. ASIFMA is based in Hong Kong and is the Asia member of the GFMA.

The GFXD was formed in co-operation with the Association for Financial Markets in Europe, Securities Industry and Financial Markets Association and ASIFMA. Its members comprise 25 global foreign exchange (FX) market participants[1], collectively representing a significant portion of the FX inter-dealer market[2]. 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.

The FX market is the world's largest financial market and effective and efficient exchange of currencies underpins the world's entire financial system. The FX market is also the basis of the global payments system. The volume of transactions is therefore very high, and these transactions are often executed by market participants across geographical borders.

Many of the current legislative and regulatory reforms have had, and will continue to have, a significant impact upon the operation of the global FX market, and the GFXD wishes to emphasise the desire of its members for globally coordinated regulation, which we believe will be of benefit to both regulators and market participants alike.

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In relation to the section of the Impact Assessment titled *"Urgent issue 2: Ensuring a level playing field / international perspectives"* we welcome the Commission's consideration of the extraterritorial impact of the BMR and the associated challenges facing EU firms in their cross-border businesses.

The BMR was designed to implement the IOSCO 'Principles for Financial Benchmarks'. It was written to protect European investors and users of both domestic and third country benchmarks through improved governance and oversight of benchmark production as well as greater transparency of the calculation methodologies used. There was also an expectation that other jurisdictions would implement similar regulatory regimes. However, as the Commission recognises *"the third country regime provided by the BMR has had the unexpected effect of creating a risk of EU investors and businesses losing access to a number of non-EU benchmarks on which they depend e.g., to hedge exposure to interest rate or FX risk in their daily business."*

As is now clear, many jurisdictions have not implemented similar regulations, and those that have introduced benchmark regulations have limited the oversight to only domestic significant benchmarks which are typically the major interest rate benchmarks.

Where equivalence has been granted to third-country legislative regimes, i.e. Australia and Singapore, governance is primarily focused on domestic systemically important interest rate benchmarks. In Japan,

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[1] Bank of America, Bank of New York Mellon, Barclays, BNP Paribas, Citigroup, Crédit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan, Lloyds Bank, Mizuho, Morgan Stanley, MUFG Bank, NatWest Markets, Nomura, Northern Trust, Royal Bank of Canada, Scotiabank, Standard Chartered Bank, State Street, UBS, Wells Fargo and Westpac

[2] According to Euromoney surveys

for which the European Commission issued a draft equivalence decision on 4th April, only its domestic interest rate benchmarks are considered to be significant and regulated by their national regulators. In New Zealand, the regulation has adopted an opt-in rather than a mandatory approach with the result that only the administrator of the primary domestic interest rate is expected to be licensed.

Consequently, the basic assumption that Equivalence would be the primary means of authorisation under BMR has not materialised due to the unwillingness of other jurisdictions to implement similar legislation.

The alternative means of authorisation, Endorsement and Recognition, are not viable options for third-country administrators given the majority derive no financial gain from having their benchmarks used in the Union, whereas the level of fees and degree of control endorsing entities and legal representatives have sought due to concerns about the liability/risk involved are significant.

The European Commission's own consultation on the BMR in 2019 identified that *"In the absence of licensing income from EU users, many third-country benchmark administrators might not have the incentive to seek either recognition or endorsement of their benchmarks for use in the Union. This would mean that many third-country benchmarks could no longer be used in the Union."*

As at 12th April 2020, only two third country administrators had been authorised via Endorsement. This had been achieved using EU supervised entities set-up within their own corporate structure to provide self-endorsement services. This represents a significant barrier to entry for less well-resourced administrators. As of the same date, only six third-country administrators had been authorised via Recognition.

Measures need to be taken to reduce the burden of the requirements, liability and accountability imposed on legal representatives under article 32(3) and on endorsing entities under article 33(1), and in doing so, increase the willingness of firms to act as legal representatives and endorsing entities.

<u>Non-significant benchmarks</u>

Given that non-significant benchmarks are unlikely to impact on the market integrity or stability of the EU or individual Member States on the basis of proportionality, the BMR should be amended such that all non-significant benchmarks should not be required to gain authorisation via equivalence, recognition or endorsement and can continue to be used by EU supervised entities after the transition date.

In addition, all non-significant benchmarks should be provided with the opportunity to opt-in to being authorised in line with the regulation, similar to the regulatory regimes in Australia and New Zealand. Some administrators recognise that recognition through authorisation validates the integrity of their benchmarks required by investors, so where they have the means to seek authorisation they should be permitted to do so.

Where third countries have received equivalence decisions from the EC in relation to legislative regimes which cover only domestically significant benchmarks (e.g. the Australian and Singapore regimes), there should be a rebuttable presumption that benchmarks in these jurisdictions which are not subject to such a regime shall not be subject to the BMR. This treatment should be considered appropriate given that, if these benchmarks are not considered "significant" in their jurisdiction of origin, it is highly unlikely that they would be significant in the EU.

The above approach is appropriate on the basis that not only are non-significant benchmarks highly unlikely to pose a significant threat to the market integrity or financial stability of the EU, they are also the least likely category of third-country administrators to either apply for, or successfully receive, registration.

Consideration should also be given to providing an exemption to all European significant benchmarks. At the very least, the quantitative threshold for significant benchmarks should be raised from a total average value of EUR 50Bn over six months to EUR 100Bn over the same period.

Financial Instrument Scope

Article 3 (16) defines a 'financial instrument' as one that is traded on a trading venue (TOTV), submitted to be TOTV, or traded by a Systematic Internaliser (SI), as set out in the Markets in Financial Instruments Directive (MiFID II) Directive 2014/65/EU. This definition in the BMR results in a scope of financial instruments that is broader than those covered under the trading transparency requirements set out under MiFID II.

Not only does this inconsistency risk creating confusion on the part of the market, but it raises more fundamental public policy questions as to the purpose of the wider scope of the BMR vis-à-vis MiFID II.

Further, the inclusion of instruments traded by an SI within the definition of 'financial instruments' requiring registration under the BMR is practically unworkable. This is on the basis that market participants lack visibility as to whether an SI might have traded a particular instrument that is not TOTV.

Therefore, the scope of financial instrument in the BMR should be aligned to the MiFID II pre-and-post trade transparency requirements for TOTV instruments, and the reference to SI's should be removed from the definition of 'financial instrument' contained within Article 3(16).

BMR Third Country Impact on FX

As outlined in our previous correspondence with the Commission, ESMA and national competent authorities, the impact for the FX market will be extremely serious if this issue is not resolved as part of the Review of BMR.

FX Forwards, or more specifically Non-Deliverable Forwards (NDFs) and FX Non-Deliverable Options, are used by EU entities (e.g. investment firms, pension funds and manufacturers) to hedge currency exposures arising from investments or exports/imports with emerging market economies. In these economies central banks use capital controls to restrict the movement of currencies outside their local jurisdiction. Consequently, the use of forwards in the onshore market is limited and, consequently liquidity is thin. By comparison, the offshore 'non-deliverable' market tends to be more active and liquid due to the diversity and number of market participants.

There are a number of currencies in which the FX Spot rate used to calculate NDF settlement is not expected to be compliant with BMR, these include: India, South Korea, Taiwan, Philippines, Argentina, Nigeria, and Kazakhstan.

A 2018 survey of GFXD members showed that between 38% and 52% of global volumes traded in three Asian NDFs - KRW, TWD and PHP - were traded by EU entities. Given the similarity of the trading relationship between Korea and the EU[3] and India and the EU[4], it is reasonable to assume that a similar percentage of INR global volumes are traded by EU entities.

Using this data together with the reported daily average volumes and the average maturity in the reported tenor buckets from the 2019 BIS Triennial Survey, it is also possible to estimate the open interest.

	% traded with EU entities	Open Interest[5] (EUR Bn)
USD/KRW	38	931
USD/TWD	52	585
USD/INR	38[A]	775
USD/PHP	50	No data available

[A] Estimated

On average:

- 35% of the volume in the above EM currencies is traded by large commercial and investment banks and securities houses that participate in the interdealer market. This interdealer activity generates liquidity enabling banks to service to their customer's requirements, i.e. institutional and corporate customers; and
- 55% of volume is traded by liquidity providers with other financial institutions. These entities include:
  - Smaller commercial banks and securities firms servicing clients both on- and off-shore;

[3] https://ec.europa.eu/trade/policy/countries-and-regions/countries/south-korea/index_en.htm

[4] https://ec.europa.eu/trade/policy/countries-and-regions/countries/india/index_en.htm

[5] https://www.bis.org/statistics/rpfx19_fx.htm. Our estimate uses the reported daily average volumes and the average maturity in the reported tenor buckets to calculate the open interest.

- International institutional investors, such as mutual funds, pension funds and insurance companies, that trade FX products for hedging onshore exposures, investing and risk management purposes;
- Hedge Funds and Proprietary Trading Firms catering to sophisticated investors or institutions in a similar way to institutional investors as well as trading for increasing exposures; and
- To a lesser extent, corporates.

Despite being an OTC market, NDF currencies, such as INR, KRW, TWD and PHP, are actively traded on regulated platforms. These regulated platforms are fundamental to the market's structure and critical to providing liquidity and transparency to the FX market.

Interbank trades are not executed bilaterally but are traded on the primary electronic execution platforms such as NEX Markets (previously EBS) and Refinitiv, both of which are regulated as MTFs. Primary platforms are a critical source of liquidity that enables banks to service their client's needs.

For institutional investors and the more sophisticated corporates, banks will provide prices to their clients via multi-dealer platforms, such as FXAll and 360T, that are regulated as MTFs using liquidity sourced from the primary platforms. These multi-dealer platforms are critical to institutional investors who are obliged to provide their clients with best execution. Whilst, price is not the only determinant in achieving best execution it is a key component and being able to see prices being quoted by multiple banks on a single venue is critical to meeting the best execution obligations. Obviously trading bilaterally continues to be an option, but it introduces execution risk that is extremely difficult to mitigate, particularly in more volatile emerging market NDF currencies.

Using data collected from the operator of a multi-dealer platform regulated as both an MTF and a Swap Execution Facility (SEF) by the CFTC, approximately 47% of 2020 year-to-date total volume traded on the platform has been traded on the MTF, 37% has been traded on the SEF, and 16% has been traded on a bilateral basis. Unfortunately, the platform is unable to provide the origin of execution, but using the 2019 BIS Triennial Survey it is possible to estimate the volumes executed by jurisdiction:

In Europe, London is the primary FX dealing centre – based on BIS data, 43% of the global average daily volume is traded in London.

For the Asian currencies where data is available, i.e. USD/INR, USD/KRW, and USD/TWD, approximately 95% of average daily volume traded in Europe is traded in the UK, 2% is traded in France and <1% is traded in Germany. In addition, 2% is traded in Switzerland. (NB This is pre-Brexit data and will be subject to change with volumes in the EU27 expected to grow).

Prohibiting EU supervised entities from using these products will have several significant adverse effects, including:

- EU supervised entities (such as those EU entities exporting goods and services) with local onshore exposures will be unable to hedge their currency risk and will most likely have to withdraw from those markets causing potential market instability;
- Fewer liquidity providers and a likely increase in costs for end-users able to sign-up with a non-EU liquidity provider;
- Risk of market fragmentation; and
- EU supervised entities will no longer be able to act as a source of funding for Asian entities using swaps referencing NDF benchmarks.

In order to prevent the cessation of key FX benchmarks being used in the Union and so avoid disruption and uncertainty, the BMR should be amended to exempt foreign exchange rates for restricted currencies.

Given the all-encompassing scope of BMR, the impact will also be felt in other asset classes using third country benchmarks that are unlikely to be willing to or able to qualify in time and are unlikely to impact on the market integrity or stability of the EU or individual Member States.

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We greatly appreciate the opportunity to share our views on the Inception Impact Assessment. Please do not hesitate to contact John Ball on +852 2531 6512, email jball@gfma.org should you wish to discuss the above.

Yours sincerely,

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