ISDA, ASIFMA, FIA and GFXD Publish
EU Benchmarks Regulation Review Recommendations

LONDON, June 29, 2020 – The International Swaps and Derivatives Association, Inc. (ISDA), the Asia Securities Industry and Financial Markets Association (ASIFMA), the Futures Industry Association (FIA) and the Global Foreign Exchange Division (GFXD) of the Global Financial Markets Association (GFMA) have published a set of recommendations to reform the European Union Benchmarks Regulation (BMR). The proposals are aimed at maintaining the intended protections of the BMR but reducing the potential for uncertainty and disruption and preventing EU investors from being put at a competitive disadvantage versus non-EU entities.

A key component of the recommendations is to narrow the scope of the BMR. An estimated 2.96 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. While many EU critical benchmarks have now complied with the BMR, a complex, costly and burdensome third-country benchmark regime means there are 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, 2021.

The prohibition of potentially large numbers of benchmarks would result in EU investors being unable to manage risks that arise as a result of their business activities, and could even pose a threat to financial stability, the associations say. Given no other jurisdictions have implemented similarly expansive benchmark regimes, the current regulations also disadvantage EU retail and institutional investors, making it challenging for them to realize the value of existing positions, convert overseas revenue or repatriate funds.

To prevent this, the associations recommend reversing the general prohibition on use to enable benchmarks to be used in the EU unless specifically prohibited. In addition, only those benchmarks deemed to pose a systemic threat to the EU should be subject to the full scope of the regulation, with smaller, non-significant EU and third-country benchmarks, regulated data benchmarks and public utility benchmarks (for example, FX rates used in non-deliverable forwards) exempt from mandatory compliance. As part of the proposals, a voluntary scheme would be introduced to allow out-of-scope benchmarks to be labelled as BMR compliant, acting as an incentive for administrators to meet EU standards on governance and transparency.

To reduce the risk posed by a benchmark ceasing to qualify under the BMR, 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 prohibit net new exposure to the benchmark but permit its use to continue managing existing exposures or to reduce them. End users would therefore be able to transfer their exposure to another entity outside the EU or reduce it by entering into an equal and offsetting trade.

“We believe the changes we have proposed are proportionate and achievable. Our recommendations would 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,” said Scott O’Malia, ISDA’s Chief Executive.

“The considerable extraterritorial reach of the regulation has resulted in a disproportionate compliance burden for administrators of third-country benchmarks. The indications are that only large global administrators will qualify their benchmarks, while the majority of third-country administrators will not be incentivized to incur the significant cost and administrative burdens. There are concerns that this will not only negatively impact the ability of EU firms to service their clients’ needs, but also cause disruption and fragmentation in third-country financial markets. The current review process offers the opportunity to ensure the legislation is fit for purpose and meets its original objectives,” said Mark Austen, ASIFMA CEO.

“The proposed changes in scope and approach, in particular to third-country benchmarks, represent a needed adjustment to today’s BMR regime, allowing global competitiveness of EU markets and, at the same time, continuing to protect EU investors by adopting a proportionate, balanced and practical regulatory regime for use of benchmarks in Europe,” said Walt Lukken, FIA President and CEO.

“Although these may seem like issues for third-country administrators, the inability for EU entities to enter into transactions that reference the spot FX rate of third-country restricted currencies means they are unable to hedge their currency exposure arising from investments in domestic capital markets or local infrastructure. This means it is EU investors and manufacturers that bear brunt of this. At a time when we need global trade, the impact of this on future investment strategies puts EU entities at a competitive disadvantage – with potential to also disrupt global markets. The European Commission's review of the legislation offers an opportunity to rectify unintended consequences and enable viable solutions to be found to avoid significant market disruption,” said James Kemp, Managing Director, GFXD.

The full set of recommendations include:

- Allow benchmarks to be used in the EU unless specifically prohibited (ie, a reversal of the current general prohibition of benchmarks unless specifically authorized).
- Provide designatory powers to an appropriate central authority (such as the European Commission (EC) or the European Securities and Markets Authority (ESMA)) to mandate compliance for those EU and third-country benchmarks that are most systemically important to investors in the EU.

- Allow third-country administrators to obtain authorization from an appropriate central authority (such as the EC or ESMA), or to qualify via equivalence, or via reformed endorsement or recognition processes, each within a fixed period of time.
- Exempt EU non-significant benchmarks and their equivalent third-country benchmarks from mandatory designation.
- Consider exempting EU significant benchmarks and their equivalent third-country benchmarks from mandatory designation in order to better align the BMR with the scope of benchmark regulations globally.
- Exempt public policy benchmarks (eg, FX rates used in non-deliverable forwards) and certain interest rate swaps) and regulated data benchmarks.
- Provide a voluntary labelling regime to allow administrators to comply with the BMR and market their benchmarks as BMR-compliant.
- Provide regulators with the power to prohibit the acquisition of new exposure to benchmarks that fail to comply with the BMR, but permit the use of such benchmarks for managing or reducing legacy positions (including undertaking new transactions for such purposes).
- Provide 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 ESMA register.

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 900 member institutions from 74 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
The Asia Securities Industry and Financial Markets Association (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.

About FIA
FIA is the leading global trade organization for the futures, options, and centrally cleared derivatives markets, with offices in London, Brussels, Singapore and Washington, DC. 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. FIA's membership includes clearing firms, exchanges, clearing houses, trading firms and commodities specialists from about 50 countries, as well as technology vendors, law firms and other professional service providers..

About GFXD
The Global Foreign Exchange Division (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 24 global foreign exchange (FX) market participants, collectively representing a significant portion of the FX inter-dealer market. 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.