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Mr Tilman Lueder
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DG FISMA, European Commission
Rue de Spa 2
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Re: Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 2016/1011 as regards the exemption of certain third country foreign exchange benchmarks and the designation of replacement benchmarks for certain benchmarks in cessation

Dear Mr. Lueder,

The Global Foreign Exchange Division (“GFXD”) of the Global Financial Markets Association welcomes the opportunity to provide comments to the European Commission (“Commission”) on its proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 2016/1011 (“EU BMR”) as regards the exemption of certain third country foreign exchange benchmarks and the designation of replacement benchmarks for certain benchmarks in cessation (“Legislative Proposal”) and Impact Assessment Report (“Impact Assessment”).

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 24 global foreign exchange (FX) market participants¹, collectively representing the majority of the FX inter-dealer market². 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.

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, Standard Chartered Bank, State Street, UBS, Wells Fargo and Westpac

² According to Euromoney surveys

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.

Robust benchmarks are key to the functioning of the FX markets and we support the efforts of the Commission to create a framework for ensuring the integrity of benchmarks in the EU. However, the extraterritorial scope of the EU BMR risks a reduction in the number of third-country benchmarks available to EU supervised entities at the end of the transitional period. The consequence of this will be to reduce market liquidity while increasing fragmentation and concentration risk for all market participants. Further, it will significantly hinder the ability of European banks, companies and investment institutions to hedge exposure to third-country domestic markets and significantly impair the ability of EU supervised entities and investors to access certain markets. The GFXD has therefore supported the Commission and Competent Authorities by inputting into the reform process, as well as third country administrators and authorities by raising awareness of, and engagement with, the EU BMR.

Proposed Exemption for Spot FX Rates in Restricted Currencies

The GFXD welcomes the Commission's recognition of the need for continued access by EU Supervised Entities to spot FX rates after the end of the transitional period. The analysis provided on page 20ff of the Impact Assessment is comprehensive and recognises the concerns articulated by the GFXD and other industry bodies about the importance of spot FX rates for calculating the pay-outs that arise under non-deliverable FX derivative (i.e. non-spot) contracts in hedging exposures to third-country domestic markets. For example, see our briefing paper 'The Importance of Reforming the EU Benchmarks Regulation'³ and response to the Commission's Inception Impact Assessment on its Review of the EU BMR.⁴

In relation to the options presented on page 41 of the Impact Assessment, while we support the Commission's analysis and its decision to pursue Option 3, an exemption for spot FX rates in restricted currencies, our preference would be for spot FX rates that are not freely convertible to be out of scope without the need for the Commission to designate them as such. If there is to be a designatory regime, we believe the Commission should be able to designate all spot FX rates which reference a currency that is not freely convertible, regardless of whether they are widely used in the Union or whether they are used to hedge against adverse movements.

In relation to the practical operation of such an exemption, we have identified three issues with the Legislative Proposal, which we outline below. We also note the potential for divergence between the

³ <https://www.gfma.org/wp-content/uploads/2020/06/20200629-bmr-review-advocacy-paper-final.docx-1.pdf>

⁴ https://www.gfma.org/wp-content/uploads/2020/04/asifma_gfxd-response-to-impact-assessment-final-200415.pdf

EU and UK after the end of the Brexit transitional period, and the outstanding third country issues relating to the EU BMR. We would be happy to discuss these points in more detail.

Open Issues

1. Definition of "frequent, systematic and regular basis" under Article 1(1)(b) of the Draft Delegated Act

One of the criteria for the exemption is that “supervised entities use the foreign exchange benchmark on a frequent, systematic and regular basis in derivative contracts for hedging against third country currency volatility”. This is to be further defined in another Delegated Act to be adopted by the Commission.

Without definition of "frequent, systematic and regular basis", it is not possible to determine which specific rates qualify under the exemption or whether these are appropriate measures by which to judge the inclusion of specific rates in the exemption. This is further exacerbated by the fact that there are no readily available sources of data available to show how widely used these benchmarks are in the EU.

Furthermore, they do not take into account the total value of the contracts for which the rates are used. This should be considered alongside the frequency of usage, given the analysis in the Impact Assessment of the proportion of the affected instruments which is traded in the EU.

We recommend that the Commission should be able to designate all spot FX rates which reference a currency that is not freely convertible, regardless of whether they are widely used in the Union or whether they are used to hedge against adverse movements.

2. Determination of the currencies to be included in the initial list

If the Commission proceeds with using the above criteria, there will be a lack of clarity as to which rates will qualify for the exemption under the Commission’s initial assessment. This is not likely to become clear until the Commission is able to adopt the additional Delegated Act, which would also leave market participants little time to prepare for the end of the transitional period if key rates are not included in the exemption.

Our previous advocacy has focused on Asian FX rates which we know to be widely used by EU supervised entities in order to demonstrate the potential negative impact to both financial markets and corporates that could arise if they were to become prohibited. There are likely to be other FX benchmarks that reference non-convertible currencies which have lower levels of liquidity and which also need to be made out of scope in order to avoid becoming prohibited. We note the list given on page 21 of the Impact Assessment (KRW, TWD, PHP, INR, ARS, NGN and KZIT). We recommend that the Commission’s initial determination of "frequent, systematic and regular " be calibrated so as to capture these Spot FX rates at a minimum.

3. *Reporting by Competent Authorities under Article 1(1)(b) of the Legislative Proposal on "the number of derivative contracts used for hedging against third country currency volatility at least every two years"*

The Legislative Proposal places a reporting requirement upon Competent Authorities to support the determination of which spot FX rates are to be included in the exemption. It is unclear from which existing data Competent Authorities will be able to draw these reports. While transaction and trade reports are made under MiFIR and EMIR⁵ (noting that the latter are made to ESMA, rather than to National Competent Authorities), there are well publicised challenges with the quality of data reported under these regulations.⁶

Furthermore, a non-deliverable contract such as a non-deliverable forward (NDF) can be used for a number of different purposes which are not recorded at the time of execution. Consequently, it would be extremely difficult to demonstrate where they are used to hedge against adverse foreign spot exchange rate movements as required by the Legislative Proposal. Therefore, if Competent Authorities are required to report on the number of derivative contracts, they would have to create a new mechanism to determine the purpose for which NDF contracts are used.

We would recommend that the obligation on Competent Authorities to report be removed due to the lack of data available and the excessive administrative burden that said reporting would place on Competent Authorities and market participants.

EU-UK Alignment

We note that in the UK, HM Treasury has recently signalled its intention to amend the transitional period for third country benchmarks to 31 December 2025 in its on-shored Benchmarks Regulation.⁷

While we support both the extension proposed by the UK and the Commission's Legislative Proposal, we note that these divergent approaches are likely to result in fragmentation of the financial markets at the end of the current EU transitional period at end-2021. As outlined in a recent report by ASIFMA⁸, regulatory fragmentation introduces market distortions and inefficiencies and is likely to have a material impact on the real economy's ability to access well-priced financial services.

The HM Treasury proposal is driven by the fact that (i) most non-EEA jurisdictions do not have benchmark-specific regulatory rules and therefore its domestic benchmarks will not be able to avail themselves of an equivalence decision; (ii) concerns have been raised about the lack of clarity around

⁵ Regulation (EU) No 600/2014 and Regulation (EU) No 648/2012

⁶ For example, ESMA's recent consultation on "Technical standards on reporting, data quality, data access and registration of Trade Repositories under EMIR REFIT" contained a number of proposed enhancements to address shortcomings in the current reporting process

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https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/901963/Third_Country_Benchmarks_Policy_Statement.pdf

⁸ <https://www.asifma.org/wp-content/uploads/2020/08/asifma-fragmentation-paper-f20200804.pdf>

the legal framework for endorsement and recognition; and (iii) the lack of economic incentives for non-EEA administrators seek authorisation via endorsement or recognition.

HM Treasury considers that additional time alone, even until December 2022 under the UK BMR transitional period, is unlikely to resolve these concerns and ensure that UK markets continue to have access to third country benchmarks and recognises that losing access to these benchmarks could have serious repercussions given their widespread use by UK firms for risk management, treasury financing and overseas investment.

We strongly recommend that, in line with HM Treasury, the Commission gives serious consideration to a similar extension to the transition period for third-country benchmarks under the EU BMR. Failure to do so could result in a situation where some third country benchmarks (including any spot FX rates referencing non-convertible currencies which do not meet the terms of the Commission's proposed designation), could continue to be referenced in the UK, but not in the EU, after end-2021. This may impact the financial stability, the real economy and financing of businesses in the EU and individual Member States.

Broader Third Country Issues

Finally, while we support the Commission's initiative in relation to spot FX rates, we would reiterate our concerns about the continued extraterritorial reach of the EU BMR in general and the continued risk to access to third-country rates which are not addressed by this FX exemption.

We note Recital 40 of the EU BMR: "Due to the existence of a large variety of types and sizes of benchmarks, it is important to introduce proportionality in this Regulation and to avoid putting an excessive administrative burden on administrators of benchmarks the cessation of which poses less threat to the wider financial system." Proportionality is also a key theme running through the IOSCO Principles for Financial Benchmarks.⁹

However, as outlined in our recent joint trade association paper¹⁰ on the need for wider reforms to the EU BMR, the general prohibition by Supervised Entities on use of any benchmark globally that is not compliant with the EU BMR gives it extraterritorial impacts far beyond those envisaged by the IOSCO Principles and has resulted in a disproportionate compliance burden being placed upon benchmark users, administrators and contributors. The need for proportionality given the broad scope of EU BMR has also been noted by ESMA's Securities and Markets Stakeholder Group's (SMSG).¹¹

For this reason, we recommend that a broader exemption (i.e. in addition to the FX exemption proposed) for 'non-significant' benchmarks, both EU and third country, be adopted. Non-significant benchmarks do not have a substantial impact on market integrity, financial stability, consumers, the real economy or the financing of households and businesses in the EU or individual Member States.

⁹ <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf>

¹⁰ <https://www.gfma.org/wp-content/uploads/2020/06/20200629-bmr-review-advocacy-paper-final.docx-1.pdf>

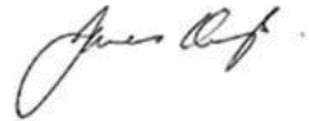
¹¹ <https://www.esma.europa.eu/press-news/esma-news/esma-issues-guidelines-non-significant-benchmarks>

Their administrators are also least equipped to qualify their benchmarks by means of the costly and burdensome Recognition or Endorsement routes and cannot benefit from Equivalence decisions.

Furthermore, these routes to compliance for third country benchmarks remain flawed, even following the changes brought by the Review of the European Supervisory Authorities.¹² Therefore, we recommend that a more comprehensive review of the EU BMR be undertaken prior to the end of the transition period not only review the scope of benchmarks captured but also to recalibrate the requirements of Recognition or Endorsement, such as the role and responsibilities of legal representatives and endorsing administrators.

We greatly appreciate the opportunity to share our views on the Legislative Proposal. 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,



James Kemp
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¹² Regulation (EU) 2019/2175