Opinion of the European Economic and Social Committee on ‘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’

(COM(2020) 337 final – 2020/0154 (COD))

(2021/C 10/06)

Rapporteur-general: **Christophe LEFÈVRE**

Referral	Council of the European Union, 28.8.2020
	European Parliament, 14.9.2020
Legal basis	Articles 114 and 304 of the Treaty on the Functioning of the European Union
Section responsible	Economic and Monetary Union and Economic and Social Cohesion
Bureau decision	14.7.2020
Adopted at plenary	29.10.2020
Plenary session No	555
Outcome of vote	244/0/7
(for/against/abstentions)	

1. **Conclusions and recommendations**

1.1. In line with the recommendations made in its opinions [1], and noting in particular that LIBOR [2] will cease to be published, the EESC welcomes the European Commission’s proposals to ensure continuity in the operating provisions of financial operators in the Capital Markets Union (CMU) as regards the exemption for certain third country exchange rate benchmarks and the designation of replacement benchmarks for certain benchmarks in cessation.

1.2. The proposals not only provide a direct response to the consequences of LIBOR no longer being published and of the United Kingdom’s withdrawal from the European Union, but also provide an opportunity to include the situation of benchmarks in countries where the exchange rate is not freely convertible, thus also contributing to the achievement of broader objectives.

1.3. The EESC considers that these markets need to be secure, stable and shock-resistant if the CMU is to function properly. In this regard, the cessation of LIBOR will have very significant economic consequences as a considerable number of contracts do not contain fall-back provisions that take account of LIBOR no longer being used as a reference by the end of 2021.

1.4. It is therefore paramount and a matter of priority to organise the replacement of the LIBOR reference and, at the same time, the EESC welcomes the Commission’s proposal to involve national authorities in this process by adopting a European regulation that would neutralise the risks of disparate legislation that can be observed during the process of transposing a directive.

1.5. The EESC welcomes the fact that the proposed amendments to the Benchmark Regulation will introduce a statutory power, whereby the European Commission designates a replacement rate if and when a benchmark whose cessation would result in significant disruption in the functioning of financial markets in the Union ceases to be published.

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(1) European System of Financial Supervision (ESFS) — Reforms (OJ C 227, 28.6.2018, p. 63), Sustainable finance: taxonomy and benchmarks (OJ C 62, 15.2.2019, p. 103) and European System of Financial Supervision (ESFS) — Amended proposal to fight money laundering (OJ C 110, 22.3.2019, p. 58).

(2) LIBOR (London Interbank Offered Rate) serves as a globally accepted key benchmark interest rate that indicates borrowing costs between banks.

1.6. The EESC also welcomes the fact that the statutory replacement rate will, by operation of the law, replace all references to the 'benchmark in cessation' in all contracts entered into by an EU supervised entity.

1.7. The EESC considers it appropriate that for contracts not involving an EU supervised entity, Member States are encouraged to adopt national statutory replacement rates.

1.8. Finally, in order to monitor the appropriateness of the newly introduced exemption, the EESC endorses the proposal that competent authorities and supervised entities be required to periodically report to the Commission on the use of the exempted benchmarks by EU businesses and on the changes in the balance sheets of supervised entities in terms of exposure to third country currency fluctuation.

1.9. The decision is in line with the recommendations of the Financial Stability Board ([3]), though the EESC would query the fact that, considering the global activity here, the European Union seems to be the only jurisdiction seeking to regulate the mechanism for the functioning of spot exchange rate benchmarks.

1.10. The EESC recommends, of course, that implementation of the regulation and its incorporation into financial markets be monitored. For the EESC, it is essential that the rules envisaged make a tangible and direct contribution to achieving the objectives and that they deliver beneficial results for all parties concerned in all Member States.

2. **Background**

2.1. The Commission work programme for 2020 provides for a review of the regulation on financial indices (referred to as the 'Benchmark Regulation') used as benchmarks for determining the amount to be paid under a financial instrument or financial contract or the value of a financial instrument. In order to strengthen the trust of capital market participants in indices serving as benchmarks in the Union, the Benchmark Regulation sets governance and data quality standards for benchmarks used in financial contracts. It contributes to the Commission's efforts in favour of a Capital Markets Union (CMU).

2.2. The Benchmark Regulation introduces an authorisation obligation for administrators of financial benchmarks, imposes requirements on contributors of input data used to calculate the financial benchmark and also regulates the use of financial benchmarks. The Benchmark Regulation requires EU supervised entities (such as banks, investment firms, insurance companies and undertakings for collective investment in transferable securities — UCITS) to use only indices whose administrator has been authorised. Benchmarks administered in third countries can only be used in the EU following an equivalence, recognition or endorsement procedure.

2.3. The Benchmark Regulation has been applicable since January 2018. However, until the transitional regime expires at the end of December 2021, EU market participants may continue to use benchmarks administered in a country outside the Union regardless of whether an equivalence decision is in place or whether the index has been recognised or endorsed for use in the Union.

2.4. First, the amendments to the Benchmark Regulation proposed in the legislative proposal being considered in this EESC opinion will introduce a statutory power, whereby the European Commission designates a replacement rate if and when a benchmark whose cessation would result in significant disruption in the functioning of financial markets in the Union ceases to be published.

2.5. Second, the statutory replacement rate will, by operation of the law, replace all references to the 'benchmark in cessation' in all contracts entered into by an EU supervised entity.

2.6. Third, for contracts not involving an EU supervised entity, Member States are encouraged to adopt national statutory replacement rates.

([3]) International economic body established after the G20 London summit in April 2009. It brings together 26 national financial authorities (central banks, finance ministries, etc.), as well as several international organisations and standard-setting bodies in the area of financial stability.

2.7. Finally, in order to monitor the appropriateness of the newly introduced exemption, competent authorities and supervised entities are required to periodically report to the European Commission on the use of the exempted benchmarks by EU businesses and on the changes in the balance sheets of supervised entities in terms of exposure to third country currency fluctuation.

3. **Comments**

3.1. In line with the recommendations made in its opinions [4], and noting in particular that LIBOR will cease to be published, the EESC welcomes the Commission's proposals to maintain continuity in the operating provisions of financial operators in the CMU **as regards the exemption for certain third country exchange rate benchmarks and the designation of replacement benchmarks for certain benchmarks in cessation**.

3.2. The proposals are not only a direct response to the consequences of the United Kingdom's departure from the EU, but also provide an opportunity to include the situation of benchmarks in countries where the exchange rate is not freely convertible, thus also contributing to the achievement of broader objectives.

3.3. The proposals mean that account can be taken of the use of exchange rate benchmarks to cover volatility in the currency of a third country, as well as the payment of derivative contracts in a currency other than a currency with limited convertibility, in particular where the third country currency is not freely convertible.

3.4. This reform is essential to keep pace with abrupt changes, linked to Brexit, in the CMU in conjunction with the Banking Union, to ensure the functioning of Economic and Monetary Union (EMU) and to help strengthen the position of the EU and its Member States in a global environment in the throes of change.

3.5. The reform of vital benchmarks, such as IBOR rates [5], has been made a top priority in the Commission's Action Plan on CMU, in line with the recommendations of the Financial Stability Board.

3.6. These markets need to be secure, stable and shock-resistant if the CMU is to function properly. As such, the impact of the cessation of LIBOR, even if following on from a progressive loss of capacity to reflect the underlying market or economic reality that it sought to measure, will have very significant economic consequences as a considerable number of contracts do not contain fall-back provisions to cover the period until the end of 2021, when LIBOR will cease to be used as a reference.

3.7. It is therefore paramount and a matter of priority to organise the replacement of the LIBOR reference and, at the same time, the EESC welcomes the European Commission's proposal to involve national authorities in this process by adopting a European regulation that would neutralise the risks of disparate legislation that can be observed during the process of transposing a directive.

3.8. For businesses and communities, which were consulted beforehand by the European Commission, the adoption of benchmarks helps to make cross-border market transactions secure and to strengthen the level playing field, especially for countries where the exchange rate is still over-regulated.

3.9. This regulatory amendment is designed to address an extremely important systemic risk: the range of contracts that will be affected by the cessation of a widely-used interest rate benchmark includes:

(a) debt issuances by supervised entities;

(b) debt held on the balance sheet of supervised entities;

(c) loans;

(d) deposits; and

(e) derivative contracts.

A large part of the financial contracts that reference widely-used interest rate benchmarks involve supervised entities within the scope of the Benchmark Regulation.

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(4) European System of Financial Supervision (ESFS) — Reforms (OJ C 227, 28.6.2018, p. 63), Sustainable finance: taxonomy and benchmarks (OJ C 62, 15.2.2019, p. 103) and European System of Financial Supervision (ESFS) — Amended proposal to fight money laundering (OJ C 110, 22.3.2019, p. 58).

(5) Interbank offer rates (IBOR) are systemically important benchmarks, underpinning many contracts in the financial sector.

3.10. The legal uncertainty and potentially adverse economic impact that may result from difficulties in the ability to enforce contractual obligations will pose a risk for financial stability in the Union:

— for their part, consumers, small, medium-sized and large companies and investors will benefit from better protection, and this proposal introduces various tools to ensure that the wind-down of a widely-used interbank rate does not unduly affect the ability of the banking sector to provide financing to EU companies, something that would undermine a key objective of the Capital Markets Union;

— in this respect, we feel it is worth analysing the following recitals in the text as well, in relation to the Commission's proposal:

(i) the recitals and explanatory memorandum seem to regard a wide range of contracts that use financial benchmarks, including credit agreements (or similar lending facilities) concluded with legal persons or similar (not only consumers); in this regard, we would point to the section on the 'Scope of the statutory replacement rate';

(ii) the wording of the Commission proposal that establishes the replacement by operation of law — Article 23a(2) — uses the term 'financial contracts', which is defined in the Benchmark Regulation (Article 3(1)(18)) only in relation to credit agreements concluded with natural persons — consumers — given the references to Directive 2014/17/EU and Directive 2008/48/EC;

(iii) in order to ensure consistency between the aim expressed in the explanatory memorandum and the text of the proposal, we feel it is worth analysing the reference to and definition of the term 'financial contracts', so that this is not limited only to credit agreements concluded with consumers, but rather ensures the effectiveness of the replacement mechanism by operation of law also with regard to credit agreements concluded with other market players;

— the EESC considers that the replacement powers should extend to all contracts under the law of an EU Member State, as well as to contracts concluded between entities established in the EU that are governed by a non-EU law, where that third country law does not provide a statutory replacement for a discontinued benchmark;

— the measures proposed are to be considered as contributing to *'an economy that works for people'* (Commission work programme for 2020). This initiative benefits bank loans to retail customers that are indexed to IBOR rates, an important element of an economy that serves people's needs.

3.11. Given that recital 10 of the proposal for an amendment refers to taking into account the recommendations of the working groups, and that at least in the case of the transition from Eonia (Euro Overnight Index Average) to €STR (Euro short-term rate) the working group recommended that the transition be to €STR + spread, the EESC considers that it would be useful to confirm that 'replacement benchmark' should be understood to mean 'new benchmark + spread'.

3.12. We feel that it would be useful to clarify the phrase 'significant disruption in the functioning of financial markets in the Union'. On this point, based on the provisions of recital 4 we can deduce that ending the publication of LIBOR falls into this category, but if we take the long-term view and consider that at some point we may be faced with the cessation of EURIBOR, a definition of the concept would be advisable.

3.13. The EESC considers that it would also be useful to refer to the conditions under which the Commission will implement this legislation, i.e. how long after the stipulated conditions are met will the replacement benchmark be designated.

3.14. Another useful clarification to add concerns the degree of extra-territoriality of the application of this measure. That is to say, this measure applies when one of the supervised entities has its head office in one of the Member States, regardless of the law governing the contract; we refer here particularly to contracts governed by English law, as from 1 January 2021 this will become the law of a third country.

3.15. Reform of the Benchmark Regulation is therefore the right tool to establish a statutory replacement rate that mitigates any adverse consequences for legal certainty and financial stability that might ensue if LIBOR, or any other benchmark whose cessation would result in significant disruption in the functioning of the Union's financial markets, were discontinued without such a replacement rate being both available and integrated into existing legacy contracts involving supervised entities falling within the scope of the regulation.

3.16. The decision is in line with the recommendations of the Financial Stability Board, though the EESC would query the fact that when considering the global activity here, the European Union seems to be the only jurisdiction seeking to regulate the mechanism for the functioning of spot exchange rate benchmarks.

3.17. The EESC recommends, of course, that implementation of the regulation and its incorporation into financial markets be monitored. For the EESC, it is essential that the rules envisaged make a tangible and direct contribution to achieving the objectives and that they deliver beneficial results for all parties concerned in all Member States.

Brussels, 29 October 2020.

The President
of the European Economic and Social Committee
Christa SCHWENG