

# Review of the Benchmark Regulation

## To address the phasing-out of the London Interbank Offered Rate (LIBOR) index

*This briefing is one in a series of 'implementation appraisals', produced by the European Parliamentary Research Service (EPRS), on the operation of existing European Union (EU) legislation in practice. Each briefing focuses on a specific EU law which is likely to be amended or reviewed, as planned in the European Commission's annual work programme. 'Implementation appraisals' aim at providing a succinct overview of publicly available material on the implementation, application and effectiveness to date of specific EU law, drawing on input from EU institutions and bodies, as well as external organisations. They are provided by the Ex-Post Evaluation Unit of EPRS, to assist parliamentary committees in their consideration of new European Commission proposals, once tabled.<sup>1</sup>*

### SUMMARY

Following the London Interbank Offered Rate (LIBOR) scandal in 2012, the European Commission proposed a regulation on indices used as benchmarks in financial instruments and financial contracts. The resulting Benchmark Regulation (Regulation (EU) 2016/1011) entered into force on 30 June 2016, and into application in January 2018.

On 27 July 2017, the United Kingdom (UK) Financial Conduct Authority (FCA) announced its intention to phase out the London Interbank Offered Rate (LIBOR) by the end of 2021. As supervisor of the LIBOR, the FCA sought to allow for a smooth transition from this widely used benchmark to alternative reference rates.

The European Commission adopted a proposal to amend the Benchmarks Regulation on 24 July 2020. The proposal's most important ambition is to regulate the replacement rate of a benchmark in cessation (in this case: LIBOR) and to avoid a legal vacuum.

This amendment would empower the European Commission to designate, by an implementing act, a statutory replacement rate to replace the reference to the benchmark in cessation, if this cessation could result in significant disruption of financial markets in the Union.

# 1. Background and content of the Benchmark Regulation

Considering the importance of benchmarks in providing reference prices for financial instruments or financial contracts, cases of manipulation of benchmarks<sup>2</sup> (such as LIBOR and EURIBOR, commonly known as the 2012 LIBOR scandal) demanded an international and European level reaction. According to estimates published by the European Commission, the volume of markets impacted by benchmarks could be over €1 000 trillion.<sup>3</sup>

The European Commission therefore adopted a proposal for a regulation on indices used as benchmarks in financial instruments and financial contracts in 2013.<sup>4</sup> Beyond the economic importance of benchmarks in general, the European

Commission also highlighted the role of benchmarks for the effective functioning of the internal market and for consumer and investor protection. A legislative action at EU level was necessary to ensure a consistent approach in all EU Member States, to guarantee legal certainty for the use of benchmarks within the internal market and to restore trust of capital markets in such benchmarks.

## What is a benchmark?

*'A benchmark is an index (statistical measure), calculated from a representative set of underlying data, that is used as a reference price for a financial instrument or financial contract, or to measure the performance of an investment fund.'*

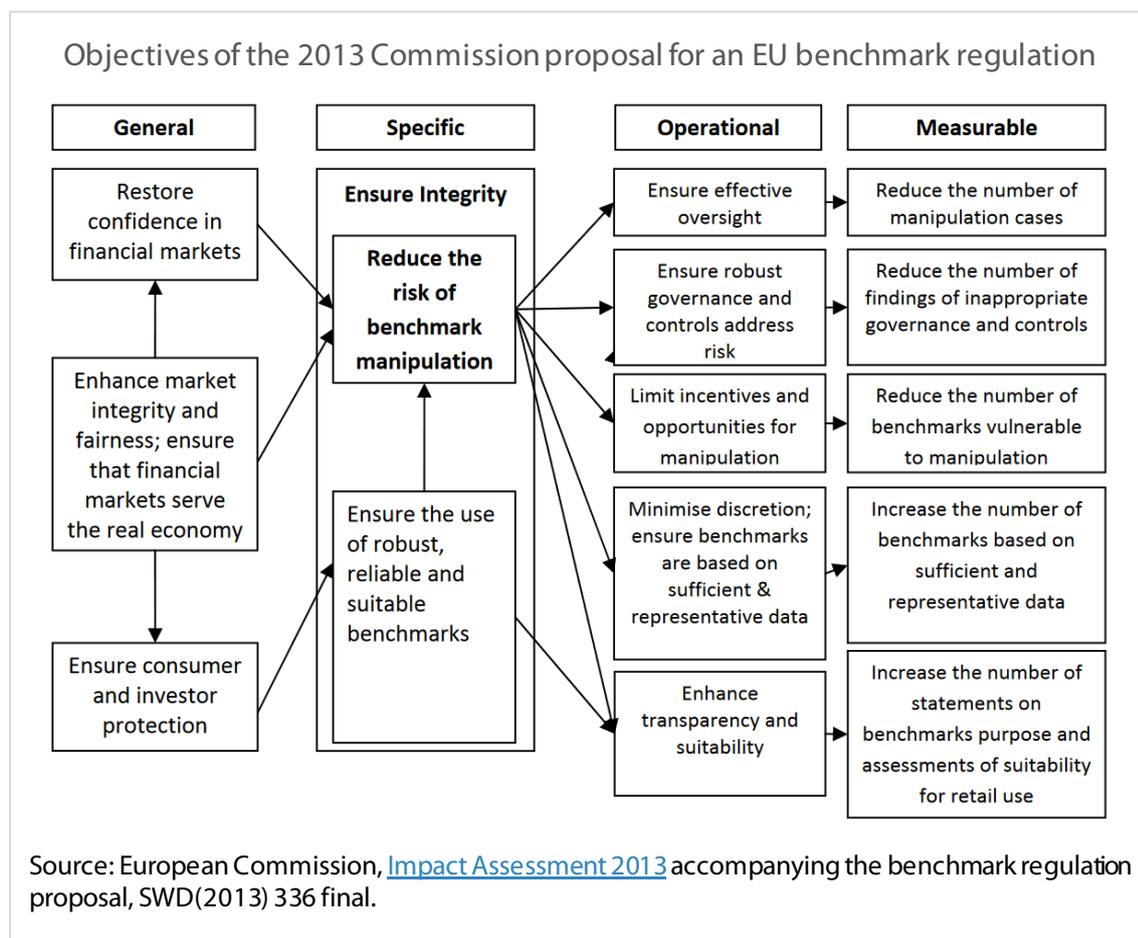
Definition taken from European Parliament, [Legislative Train Schedule file on the review of the Benchmark Regulation \(EU\) 2016/1011](#), June 2020.

## 1.1. Objectives of the existing benchmark regulation

The European Commission's 2013 proposal for a benchmark regulation had four main objectives:

- Improvement in governance and control of the benchmark process through avoidance of conflicts of interest within benchmark administrators (see below);
- Improvement of the quality of the input data and methodologies used by benchmark administrators by ensuring that sufficient and accurate data is used in the determination of benchmarks;
- Adequate control of contributors to benchmarks, in particular to avoid conflicts of interest. Where necessary, the relevant competent authority should have the power to mandate contributors to continue to contribute to benchmarks;
- Protection for consumers and investors using benchmarks by enhancing transparency and by ensuring adequate rights of redress.

The figure below provides a more detailed overview of the general, specific and operational objectives of the proposed regulation.



An agreement on the regulation was reached between the Council of the European Union and the European Parliament in November 2015. The Parliament approved the text at first reading on 28 April 2016. On 8 June 2016, the European co-legislators adopted the Benchmark Regulation, which entered into force on 30 June 2016, and into application in January 2018.

## 1.2. Main aspects of the 2016 Benchmark Regulation

The Regulation defines the obligations of benchmark administrators and establishes three regimes of benchmarks with different levels of regulation and supervision depending on a benchmark's importance. In addition, the regulation also provides requirements for regulated data, interest rate, and commodity benchmarks. It also establishes the role of the European Securities and Markets Authority (ESMA) with regard to supervision of benchmark administrators and cooperation with third countries (see further details in the section on ESMA).

### Benchmark administrators

Benchmark administrators are natural or legal persons that control the provision of a benchmark. The Benchmark Regulation sets a framework for their authorisation and registration by competent authorities. According to the Benchmark Regulation, administrators of benchmarks have to:

- Put in place robust governance and conflict of interest requirements;
- Establish and maintain a permanent and effective oversight function and control framework for their benchmarks;
- Record data, methodology, changes to procedures, etc.;
- Set up a complaints-handling mechanism;

- Subject outsourcing to strict conditions;
- Ensure that the benchmark is built on accurate and reliable input data, preferably by using transaction data;
- Publish the methodology for determining the benchmark.

## Levels of benchmarks

The regulation establishes three separate regimes that progressively increase the level of regulation and supervision depending on a benchmark's importance:

- **critical benchmarks** are used as a reference for financial instruments, financial contracts or for measuring the performance of investment funds, having a total value of at least €500 billion or fulfil certain other criteria. Special rules apply in the event that an administrator intends to cease providing a critical benchmark;
- **significant benchmarks** are used as a reference for financial instruments, financial contracts or for measuring the performance of investment funds with a total average value of at least €50 billion or fulfil certain other criteria;
- **non-significant benchmarks** that do not fall into either of the above two categories and are subject to less burdensome rules.

Specific arrangements exist for commodity, interest rate, and regulated data benchmarks.

## 2. EU level reports, reports and studies

### 2.1. European Commission proposed amendment

On 27 July 2017, the UK Financial Conduct Authority (FCA) announced its intention to phase out the London Interbank Offered Rate (LIBOR) by the end of 2021. This decision was taken due to very low activity in the market for unsecured wholesale term lending to banks.

The cessation of LIBOR will affect those financial contracts that will not have reached maturity by the end of 2021. Without a permanent solution in the event of discontinuation of a widely used benchmark, a risk of legal uncertainty and negative economic impacts arises.

The European Commission addressed this issue in its proposed amendment to the Benchmark Regulation, adopted on 24 June 2020. The main aspects of this amendment are:

- Three different types of events could trigger action by the European Commission:
  - a public statement by the regulatory authority competent for the authorisation of the administrator of the benchmark announcing that the benchmark is no longer representative of an underlying market or economic reality on a permanent and irremediable basis;
  - a public statement by or on behalf of the administrator of a benchmark announcing that the administrator has ceased or will cease to provide the benchmark permanently;
  - a public statement by the regulatory authority competent for the authorisation of the administrator of the benchmark announcing that the administrator has ceased or will cease to provide the benchmark permanently.
- The European Commission would be empowered to designate, by an implementing act, a statutory replacement rate to replace the reference to the benchmark in cessation, if this cessation may result in significant disruption of financial markets in the Union.
- Such a replacement rate would only be available for financial instruments, financial contracts and measurements of the performance of an investment fund that uses this benchmark as a reference at the time of its cessation and that contain no suitable fall-back provisions.
- Competent authorities of supervised entities using the replaced benchmark would have to monitor whether the replacement has minimised contract frustration or any other

detrimental effects on economic growth and investments in the Union, and report to the European Commission and to ESMA.

Besides the amendment in relation to the cessation of a financial benchmark, the European Commission also proposed an adjustment to the Benchmark Regulation to ensure that European companies can continue using currency benchmarks provided outside the EU, to allow them to cover the risk of foreign currency fluctuations in their exporting and foreign investment activities.

## 2.2. Expert Group of the European Securities Committee (EGESC)

The EGESC is a consultative entity set up by the European Commission to provide advice and expertise on securities law to the Commission and its services. In this role, its members (Member State authorities) assist the Commission in the preparation of legislative proposals and policy initiatives.

The proposal for an amendment of the Benchmark Regulation appeared on the agenda of three meetings of the EGESC in 2020, on 24 April, 11 May and 14 July.<sup>5</sup> In the course of these meetings, questions on the duration of the legacy rate were raised. Most Member States were not in favour of a firm end date for the synthetic LIBOR (i.e. a rate that reproduces the important characteristics of an IBOR rate without reflecting real market movements), but to instead leave the decision on the end date to the competent national authority. The European Commission proposal of 24 July 2020 does not contain any provision on a firm end date. In the EGESC, Member States also asked about the formula to be used for a legacy rate. According to the European Commission, the formulas for legacy rates are not a subject of the legislation – the most appropriate formulas have to be determined by the national competent authority. The European Commission also specified that there would be two cut-off dates for legacy contracts, i.e. dates after which a statutory replacement rate would become applicable to contracts in course at either of these dates: (i) the date on which a regulator announces definitely that LIBOR is no longer representative, or (ii) or the definite cessation of LIBOR publication.

## 2.3. European Securities and Markets Authority (ESMA)

In reaction to the LIBOR scandal, ESMA and the European Banking Authority (EBA) adopted a set of principles for benchmark-setting processes in the EU in 2013. These principles covered all phases of the benchmark-setting process, including data submission, administration, calculation, publication, the use and the continuity of benchmarks.<sup>6</sup>

In the Benchmark Regulation context, ESMA developed draft regulatory technical standards (RTS) and implementing technical standards (ITS). In addition, ESMA supervises certain critical benchmarks at Union level and coordinates the supervision of benchmark administrators by national competent authorities. ESMA also provides technical advice to the European Commission on possible delegated acts and has established and maintains a register of administrators and third-country benchmarks, in accordance with Article 36 of the Benchmark Regulation.

On 14 February 2020, ESMA provided its response to the Commission's consultation on the Benchmark Regulation review:<sup>7</sup>

- With respect to critical benchmarks ESMA proposes that:
  - competent authorities are able to request an administrator change its methodology;
  - the process of suspension or withdrawal of authorisation or registration of an administrator is clarified; and
  - the assessment by competent authorities of the cessation procedures of the administrator is clarified;
- In order to ensure a level playing field between EU and third country benchmarks, ESMA proposes to take into account different alternative approaches when defining the scope of the Benchmark Regulation; and

- To increase transparency to the benefit of benchmark users, ESMA proposes to include the list of both EU and third-country benchmarks in its register together with an appropriate identification of benchmarks.

## 2.4. Council of the European Union

At the time of writing this implementation appraisal, discussions in the Council were still ongoing. The review of the Benchmark Regulation featured on the agenda of the Working Party on Financial Services meeting held on 4 September 2020.

On 8 September 2020, the Council requested the European Central Bank deliver an opinion on the European Commission proposal. The following section provides details of this opinion.

## 2.5. European Central Bank (ECB)

On 18 September 2020, the ECB published its opinion on the European Commission's proposal.<sup>8</sup> The ECB welcomes the proposed empowerment of the European Commission to adopt implementing acts to designate a 'replacement benchmark for a benchmark that will cease to be published where the cessation of that publication may result in significant disruption in the functioning of financial markets in the Union'.<sup>9</sup> Nevertheless, the ECB proposed some amendments to the Commission proposal. Most importantly, the ECB stressed that recommendations on replacement benchmarks given by private sector working groups operating under the auspices of public authorities 'are entirely the recommendations of these private sector working groups, and the public authorities under whose auspices these working groups operate do not accept any responsibility or liability for the contents of the recommendations or necessarily share any of the views expressed in them'.

Already by 23 July 2020, the ECB published a report<sup>10</sup> providing good practices to assist banks in their preparation of the benchmarks rate reform. According to this report, and a second report on banks' preparedness for benchmarks rate reforms<sup>11</sup> published on the same day, banks were aware of the upcoming reform, but had focused on the transition of the euro overnight index average (EONIA) to the euro short-term rate (€STR),<sup>12</sup> rather than on the reform of the euro interbank offered rate (EURIBOR) and related risks. In addition, banks seemed to be behind schedule with their action plans in relation to the benchmarks rate reform.

The report on good practices lists risks and good practices in the areas of project management and legal and operational challenges to mitigate the risks arising in the context of the benchmarks rate reform. Finally, it also comprises a list of good practices to mitigate risk related to banks' exposure to certain benchmarks.

## 2.6. European Economic and Social Committee (EESC)

The EESC is working on the European Commission proposal for an amendment to the Benchmark Regulation, a first meeting of the study group took place on 1 September 2020. A draft opinion is planned for adoption on 19 November 2020, with the final opinion planned for adoption during the EESC's plenary session on 2-3 December 2020.<sup>13</sup>

## 3. European Parliament position

During the current parliamentary term (2019-2024), there have been no parliamentary resolutions or questions with respect to the Benchmark Regulation to date.

## MAIN REFERENCES

European Central Bank, [Report on preparations for benchmark rate reforms](#), 23 July 2020.

European Commission, [Commission Staff Working Document Impact Assessment accompanying the Proposal for a Regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts](#), SWD(2013) 336 final, 18 September 2013.

European Commission, [Proposal for a Regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts](#), COM(2013) 641 final, 18 September 2013.

European Commission, [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, 24 July 2020.

European Securities and Markets Authority, [ESMA-EBA Principles for Benchmark-Setting Processes in the EU](#), ESMA/2013/659, 6 June 2013.

## ENDNOTES

- <sup>1</sup> See also Tuominen M., [Review of the Benchmark Regulation](#), Initial Appraisal of a European Commission Impact Assessment, EPRS, European Parliament, 2020.
- <sup>2</sup> Interbank offered rates (IBORs) reflect the interest rate that banks charge each other for the borrowing of funds.
- <sup>3</sup> See European Commission, Commission Staff Working Document Impact Assessment accompanying the proposal for a regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts, SWD(2013) 336 final, 18 September 2013, p.6.
- <sup>4</sup> Speech by Andrew Bailey, Chief Executive of the FCA, at Bloomberg London, [The future of LIBOR](#), 27 June 2017.
- <sup>5</sup> See meeting minutes of the Expert Group of the European Securities Committee (EGESC) of [24 April 2020](#), [11 May 2020](#), [14 July 2020](#)
- <sup>6</sup> Press release, ESMA, [ESMA and the EBA publish final principles on benchmarks](#), 6 June 2013.
- <sup>7</sup> See [ESMA press release](#) of 14 February 2020 and the [ESMA comments](#) sent on the same day.
- <sup>8</sup> See [Opinion of the European Central Bank of 18 September 2020](#) on a 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.
- <sup>9</sup> New Article 23a of Regulation (EU) 2016/1011.
- <sup>10</sup> See [ECB Banking Supervision, Report on preparations for benchmark rate reforms](#), 23 July 2020.
- <sup>11</sup> See [ECB Banking Supervision, A horizontal assessment of SSM banks' preparedness for benchmark rate reforms](#), 23 July 2020.
- <sup>12</sup> EONIA will be discontinued on 3 January 2022 and replaced with the €STR, an overnight wholesale funding rate that is published by the ECB.
- <sup>13</sup> See EESC [Information Memo of 4 August 2020](#) on a 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.

## DISCLAIMER AND COPYRIGHT

This document is prepared for, and addressed to, the Members and staff of the European Parliament as background material to assist them in their parliamentary work. The content of the document is the sole responsibility of its author(s) and any opinions expressed herein should not be taken to represent an official position of the Parliament.

Reproduction and translation for non-commercial purposes are authorised, provided the source is acknowledged and the European Parliament is given prior notice and sent a copy.

© European Union, 2020.

[eprs@ep.europa.eu](mailto:eprs@ep.europa.eu) (contact)

[www.eprs.ep.parl.union.eu](http://www.eprs.ep.parl.union.eu) (intranet)

[www.europarl.europa.eu/thinktank](http://www.europarl.europa.eu/thinktank) (internet)

<http://epthinktank.eu> (blog)



