European Parliament
2019-2024

Committee on Economic and Monetary Affairs

2020/0154(COD)

6.10.2020

***I
DRAFT REPORT

on the 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)0337 – C9-0209/2020 – 2020/0154(COD))

Committee on Economic and Monetary Affairs

Rapporteur: Caroline Nagtegaal

Symbols for procedures

*	Consultation procedure
***	Consent procedure
***I	Ordinary legislative procedure (first reading)
***II	Ordinary legislative procedure (second reading)
***III	Ordinary legislative procedure (third reading)

(The type of procedure depends on the legal basis proposed by the draft act.)

Amendments to a draft act

Amendments by Parliament set out in two columns

Deletions are indicated in ***bold italics*** in the left-hand column. Replacements are indicated in ***bold italics*** in both columns. New text is indicated in ***bold italics*** in the right-hand column.

The first and second lines of the header of each amendment identify the relevant part of the draft act under consideration. If an amendment pertains to an existing act that the draft act is seeking to amend, the amendment heading includes a third line identifying the existing act and a fourth line identifying the provision in that act that Parliament wishes to amend.

Amendments by Parliament in the form of a consolidated text

New text is highlighted in ***bold italics***. Deletions are indicated using either the ▌ symbol or strikeout. Replacements are indicated by highlighting the new text in ***bold italics*** and by deleting or striking out the text that has been replaced.
By way of exception, purely technical changes made by the drafting departments in preparing the final text are not highlighted.

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DRAFT EUROPEAN PARLIAMENT LEGISLATIVE RESOLUTION

on the 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)0337 – C9-0209/2020 – 2020/0154(COD))

(Ordinary legislative procedure: first reading)

The European Parliament,

– having regard to the Commission proposal to Parliament and the Council (COM(2020)0337),

– having regard to Article 294(2) and Article 114 of the Treaty on the Functioning of the European Union, pursuant to which the Commission submitted the proposal to Parliament (C9-0209/2020),

– having regard to Article 294(3) of the Treaty on the Functioning of the European Union,

– having regard to Rule 59 of its Rules of Procedure,

– having regard to the report of the Committee on Economic and Monetary Affairs (A9-0000/2020),

1. Adopts its position at first reading hereinafter set out;

2. Calls on the Commission to refer the matter to Parliament again if it replaces, substantially amends or intends to substantially amend its proposal;

3. Instructs its President to forward its position to the Council, the Commission and the national parliaments.

Amendment 1

Proposal for a regulation
Title

Text proposed by the Commission	*Amendment*
Proposal for a	Proposal for a
REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL	REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
amending Regulation (EU) 2016/1011 as regards the exemption of certain third	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	country foreign exchange benchmarks and the designation of replacement benchmarks for certain benchmarks in cessation ***and amending Regulation (EU) No 648/2012***

Or. en

Amendment 2

Proposal for a regulation
Citation 3 a (new)

Text proposed by the Commission	*Amendment*
	Having regard to the opinion of the European Central Bank,

Or. en

Amendment 3

Proposal for a regulation
Recital 4

Text proposed by the Commission	*Amendment*
(4) ***The UK Financial Conduct Authority (FCA) has announced it will stop supporting the production of one of the most important interest rate benchmarks***, the London Interbank Offered Rate (LIBOR) ***by*** the end of ***2021***. ***As of the end of the transition period for the United Kingdom's withdrawal from the Union*** on 31 December ***2021, LIBOR will no longer qualify as a critical benchmark***. The cessation of LIBOR may ***nevertheless*** result in negative consequences that produce significant disruption in the functioning of financial markets in the Union. In the Union there is a stock of contracts in the areas of debt, loans, term deposits and derivatives that reference LIBOR, that mature beyond 31 December 2021 and that do not have robust contractual fall-back provisions to cover for the cessation of LIBOR. Many of those contracts cannot be renegotiated to incorporate a contractual fall-back prior to	(4) ***Following the withdrawal of the United Kingdom from*** the ***European Union***, the London Interbank Offered Rate (LIBOR) ***will cease to qualify as a critical benchmark as of*** the end of ***the transition period*** on 31 December ***2020, whereas the United Kingdom Financial Conduct Authority (FCA) has announced it will stop supporting the production of LIBOR, one of the most important interest rate benchmarks, by the end of the transitional regime on 31 December 2021***. The cessation of LIBOR may result in negative consequences that produce significant disruption in the functioning of financial markets in the Union. In the Union there is a stock of contracts in the areas of debt, loans, term deposits and derivatives that reference LIBOR, that mature beyond 31 December 2021 and that do not have robust contractual fall-back provisions to cover for the cessation of LIBOR. Many of those contracts cannot be renegotiated to

31 December 2021. The cessation of LIBOR may therefore result in significant disruption in the functioning of financial markets in the Union.	incorporate a contractual fall-back prior to 31 December 2021. The cessation of LIBOR may therefore result in significant disruption in the functioning of financial markets in the Union.

Or. en

Amendment 4

Proposal for a regulation
Recital 9

Text proposed by the Commission	*Amendment*
(9) Use of that replacement benchmark should be allowed only for contracts that have not been renegotiated prior to the cessation date of the benchmark concerned. The use of the replacement benchmark designated by the Commission should therefore be restricted to contracts already entered into by supervised entities at the moment of the entry into force of the implementing act designating the replacement benchmark. Furthermore, considering that such implementing act is aimed at ensuring contract continuity, the designation of the replacement benchmark should not affect contracts that already provide a ***suitable*** contractual fall back provision.	(9) Use of that replacement benchmark should be allowed only for contracts that have not been renegotiated prior to the cessation date of the benchmark concerned. The use of the replacement benchmark designated by the Commission should therefore be restricted to contracts already entered into by supervised entities at the moment of the entry into force of the implementing act designating the replacement benchmark. Furthermore, considering that such implementing act is aimed at ensuring contract continuity, the designation of the replacement benchmark should not affect contracts that already provide a contractual fall back provision.

Or. en

Amendment 5

Proposal for a regulation
Recital 10

Text proposed by the Commission	*Amendment*
(10) In exercising its implementing powers to designate a replacement benchmark, the Commission should take into account recommendations by private sector working groups operating under the auspices of the ***central bank responsible for*** the currency in which the interest rates	(10) In exercising its implementing powers to designate a replacement benchmark, the Commission should take into account recommendations by private sector working groups operating under the auspices of the ***public authorities of*** the currency in which the interest rates of the

of the replacement benchmark are denominated with regard to replacement rates to be used in existing financial instruments and contracts referencing the benchmark in cessation. Those recommendations should be based on extensive public consultations and expert knowledge, and reflect benchmark users' agreement about the most appropriate replacement rate for the interest rate benchmark in cessation.	replacement benchmark are denominated with regard to replacement rates to be used in existing financial instruments and contracts referencing the benchmark in cessation. Those recommendations should be based on extensive public consultations and expert knowledge, and reflect benchmark users' agreement about the most appropriate replacement rate for the interest rate benchmark in cessation. ***Furthermore, they 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.***

Or. en

Amendment 6

Proposal for a regulation
Recital 12 a (new)

Text proposed by the Commission	*Amendment*
	(12a) Regulation (EU) No 648/2012 of the European Parliament and of the Council[1a] is currently being amended for the purpose of providing clarity to market participants that transactions entered into or novated before the entry into application of the clearing or margin requirements to OTC derivative transactions referencing an interest rate benchmark (legacy trades) will not be subject to these requirements when they are novated for the sole purpose of implementing or preparing for the implementation of the interest rate benchmark reform. Regulation (EU) 2016/1011 requires supervised entities to produce and maintain robust written plans setting out the actions they would take in the event that any benchmark materially changes or ceases to be provided and to reflect those plans in the

contractual relationship with clients. In order to facilitate compliance by market participants with those obligations and action by market participants to enhance the robustness of OTC derivative contracts referencing benchmarks of any kind, Regulation (EU) No 648/2012 should be amended to make clear that legacy trades will not be subject to those clearing and margin requirements when those trades are replaced, amended or novated, whether individually or as part of changes relating to a portfolio of transactions, for the sole purpose of replacing the interest rate benchmark they refer to in order to implement or prepare for the implementation of the interest rate benchmark reform or of introducing fall-back provisions in relation to any benchmark they refer to in order to implement or prepare for that reform or otherwise in order to enhance the robustness of their contracts. Those amendments are necessary to provide clarity to market participants and should not affect the scope of the clearing and margin obligations in relation to the replacement, amendment or novation of an OTC derivatives contract for other purposes.

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[1a] ***Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.***

Or. en

Justification

*[For reference, see Recital 75aa and Article 80(1a) of Regulation (EU) ***/*** of the European Parliament and of the Council on a framework for the recovery and resolution of central counterparties]https://data.consilium.europa.eu/doc/document/ST-10341-2020-INIT/en/pdf*

Amendment 7

Proposal for a regulation
Article 1 – point 1 – point b
Regulation (EU) 2016/1011
Article 2 – paragraph 4

Text proposed by the Commission	*Amendment*
4. The Commission shall adopt delegated acts in accordance with Article 49 to create and update as appropriate a list of foreign exchange benchmarks that fulfil the criteria laid down in paragraph 3**.** ***Competent authorities of supervised entities that use third country foreign exchange benchmarks that are designated by the Commission in accordance with paragraph 3 shall report to the Commission and to ESMA on the number of derivative contracts that use that foreign exchange benchmark for hedging against third country currency volatility at least every two years***.;	4. The Commission shall adopt delegated acts in accordance with Article 49 to create and update as appropriate a list of foreign exchange benchmarks that fulfil the criteria laid down in paragraph 3***, and shall update that list on a regular basis***.

Or. en

Amendment 8

Proposal for a regulation
Article 1 – point 2
Regulation (EU) 2016/1011
Article 23a – paragraph 2 – point b

Text proposed by the Commission	*Amendment*
(b) those financial instruments, contracts or performance measurements contain no ***suitable*** fall back provisions.	(b) those financial instruments, contracts or performance measurements contain no fall back provisions.

Or. en

Amendment 9

Proposal for a regulation
Article 1 – point 2
Regulation (EU) 2016/1011
Article 23a – paragraph 3

Text proposed by the Commission	*Amendment*
(3) The Commission shall adopt implementing acts to designate a replacement benchmark in accordance with the examination procedure referred to in Article 50(2) where one of the conditions laid down in paragraph 1 is fulfilled. When adopting the implementing act referred to in paragraph 1, the Commission shall take into account, where available, the recommendation by an alternative reference rate working group operating under the auspices of ***the central bank responsible for*** the currency in which the interest rates of the replacement benchmark are denominated.	(3) The Commission shall adopt implementing acts to designate a replacement benchmark in accordance with the examination procedure referred to in Article 50(2) where one of the conditions laid down in paragraph 1 is fulfilled. When adopting the implementing act referred to in paragraph 1, the Commission shall take into account, where available, the recommendation by an alternative reference rate working group operating under the auspices of ***public authorities of*** the currency in which the interest rates of the replacement benchmark are denominated.

Or. en

Amendment 10

Proposal for a regulation
Article 1 – point 2
Regulation (EU) 2016/1011
Article 23a – paragraph 4 a (new)

Text proposed by the Commission	*Amendment*
	(4a) This Article shall apply to critical interest rate benchmarks.

Or. en

Amendment 11

Proposal for a regulation
Article 1 a (new)

Text proposed by the Commission	*Amendment*
	Article 1a
	Amendment to Regulation (EU) No 648/2012
	Article 13a of Regulation (EU) No

648/2012 is replaced by the following:

'Article 13a

Replacement of interest rate benchmarks and embedding contractual fall-backs in legacy trades

1. Counterparties as referred to in Article 11(3) may continue to apply the risk-management procedures that they have in place at the date of application of this Regulation in respect of non-centrally cleared OTC derivative contracts entered into or novated before the date on which the obligation to have risk-management procedures pursuant to Article 11(3) takes effect where, after the entry into force of this Regulation, those contracts are replaced, amended or novated for the sole purpose of replacing the interest rate benchmark they are referring to or of introducing fall-back provisions in relation to any benchmark referred to in the transaction.

2. Transactions entered into or novated before the date on which the clearing obligation takes effect pursuant to Article 4 and which, after the entry into force of this Regulation, are subsequently replaced, amended or novated for the sole purpose of replacing the interest benchmark they are referring to or of introducing fall-back provisions in relation to any benchmark referred to in the transaction, shall not, for that reason, become subject to the clearing obligation referred to in Article 4.'

Or. en

EXPLANATORY STATEMENT

General

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.

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.

The rapporteur broadly supports the proposal as published by the European Commission on July 24th, as it addresses the problem in a concise way, with a focus on targeting the risk of a potential severe disruption in financial markets. However, there are still small changes that could be done to the text.

Waiving margin and collateral requirements in cases of mandatory replacement of a benchmark

One of the problems caused by the transition caused by the cessation of one benchmark is related with EU clearing and collateral requirements for legacy contracts (those entered before EMIR clearing and collateral requirements were in effect). In this regard, co-legislators should provide more certainty to EU firms wishing to comply in full with the EU Benchmarks Regulation (BMR) by explicitly providing relief from EU clearing and collateral (for non-cleared trades) requirements for legacy contracts, amended to insert benchmark fall-back provisions in *all* derivatives asset classes.

This view was shared by ESMA in 2019 (see ESMA statement of 5 December 2019[1]), as it supported providing market operators with legal certainty by ensuring that fall-backs would not trigger clearing/margining. ESMA called '*to ensure legal certainty on this*, *in case or to the extent this is not already provided in some jurisdictions.....the ESAs are in contact with the co-legislators to see how a legislative change could…ensure this legal certainty'*.

A possible way for waiving those requirements would be to insert an amendment to Regulation (EU) No 648/2012. In the proposed amendment, it has been made explicit that all pre-EMIR contracts (not just interest rates derivatives) amended to insert benchmark 'fall-back' provisions should benefit from relief from EMIR clearing and margin requirements.

Changes reflected in AM 10 and 3.

List of foreign exchange benchmarks

The Commission proposal indicates that the European Commission would adopt Delegated Acts to update the list of foreign exchange benchmarks that fulfil the criteria. The proposed text does not make clear whether it should be necessary for the Commission to update the list if there are new additions, so it has been introduced a sentence indicating that the list had to be updated on a regular basis.

Furthermore, the obligation for Supervisory Authorities to report the Commission and to ESMA at least every two years to the number of derivative contracts that use that foreign exchange benchmark is removed.

Changes reflected in AM 6.

Limit intervention power European Commission

- *Critical interest benchmarks*

Any regulatory interference in benchmark methodologies should be minimised to instances when critical interest rate benchmarks require intervention as a last resort on market stability grounds, and thus, significant disruptions of the functioning of financial markets within the Union are to be expected.

Changes reflected in AM 7.

- *Fall-back provisions*

Any financial instruments, contracts or performance measurements which already contain fall back provisions, should not fall within the scope of power given to the European Commission, namely to designate a replacement benchmark.

[1] https://www.esma.europa.eu/sites/default/files/library/esas_2019_19_statement_on_the_introduction_of_fall-backs_in_otc_derivative_contracts_to_increase_contract_robustness.pdf

Changes reflected in AM 8 & 4.