20 November 2018

Briefing on the need to extend the transition period of the Benchmark Regulation in respect of critical and non-critical benchmarks

The Working Group on Euro Risk-free Rates ('EU RFR Working Group') recently published a *High Level Implementation Plan*[1] requesting the co-legislators of the European Union ('EU') to extend, the transition period of the EU Benchmarks Regulation[2] in respect of critical benchmarks for a minimum of 2 years.

ISDA, GFMA, FIA and EMTA wish to express their strong support for this request and to request in equally strong terms that the extension is expanded to include non-critical benchmarks for the reasons discussed below.

Executive Summary

This briefing is divided into two parts. The first part sets out the reasons why an extension needs to be granted in respect of critical benchmarks and the consequences of failing to do so. The second part explains why the end of the transition period for non-critical benchmarks could also cause economic damage to the European Union and potentially pose a threat of market and economic disruption to its citizens, corporations and other institutions.

Critical Benchmarks.

- **Status of EONIA.** EMMI has announced that, should market conditions and dynamics remain unchanged, EONIA's compliance with the EU Benchmarks Regulation cannot be warranted[3].

- **Status of EURIBOR.** There have recently been positive signs that EURIBOR is expected to be compliant. While this is welcome news, there remain some contingencies to its final approval.

- **Effect of Prohibition.** Prohibition on use of a benchmark will have an effect similar to cessation, which has been flagged by the global regulatory community as a source of systemic risk.

- **Impact on EU & Global investors.** Unless sufficient time is allowed for appropriate safeguards to be put in place, the very severe effects brought about by such prohibition (including potential insolvencies, litigation and payment failures) would be felt by EU and

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[1] https://www.ecb.europa.eu/paym/initiatives/interest_rate_benchmarks/WG_euro_risk-free_rates/shared/pdf/20180913/Item_3_High_level_implementation_plan.pdf

[2] Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014

[3] https://www.emmi-benchmarks.eu/assets/files/D0030D-2018-Eonia%20review%20state%20of%20play.pdf

global institutions, including pension and investment funds; insurance companies and banking institutions.

- **Good reasons why better preparation has not been possible.** Until early February 2018, EONIA had been expected to be reformed to comply with the EU Benchmarks Regulation. This meant that EU RFR Working Group was not convened until 28 February 2018. Consequently, ESTER[4] was not identified as the alternative risk free rate until September 2018. Its publication is not guaranteed before October 2019. Without a live rate, market participants are unable to complete preparations for transition to that rate.

- **Benefits of a run-off period.** An extension would also allow time for trades which currently reference EONIA (and potentially EURIBOR) to expire and for their exposures to be replaced by reference to ESTER. This would significantly reduce the number of 'legacy' positions which will require amendment in order to either reference ESTER or include fallback provisions.

- **No drop off in efforts.** An extension to allow all of these developments to take place would not negatively impact industry's efforts to transition. Concerns about the liquidity of the markets that EURIBOR and EONIA measure and panel bank withdrawal ensure that those running exposure to the rates will remain incentivised to transition.

Non-critical Benchmarks.

- **Use of Third Country Benchmarks.** EU investors, both retail and institutional (including corporations, insurance companies, pension funds, investment funds and banks), use benchmarks provided by administrators domiciled outside the EU (hereinafter such benchmarks referred to as "Third Country Benchmarks" and such administrators referred to as "Third Country Administrators") for many commercial purposes including to hedge the risk of losses caused by currency or market movements, converting one currency into a different currency, repatriating funds and making investments in other jurisdictions and a range of other purposes.

- **No data as to which third country benchmarks will be authorised.** There is no publicly available data to show how many such benchmarks used in the EU today are not on course to qualify for use in the EU by the end of 2019, though it seems likely to be a significant number. Without this data, market participants are unable to make any preparations in terms of reducing exposures to those benchmarks.

- **Scale of impact on EU citizens and institutions of prohibition on use of third country benchmarks.** There is no publicly available data to show the amount of exposure held by EU institutions to such benchmarks, though it seems likely to be very significant. Without this data there is no understanding of the scale of the impact that prohibiting their use in the EU will have on citizens and the institutions which serve their needs. Such institutions will no longer be able to risk manage their existing and future exposures using such benchmarks, putting them at significant risk of unmitigated losses.

[4] Euro Short-term Rate

- **EU investors at a competitive disadvantage.** European investors will be put at a very significant competitive disadvantage compared to third country investors who will continue to be able to use benchmarks prohibited from use in the EU after the end of the transition period.

- **Lack of alternatives for EU investors.** Unlike the European critical benchmarks in respect of which ESTER is being developed, there are unlikely to be alternative rates that investors from the EU can use instead of any prohibited non-critical benchmarks.

- **Significant Third Country Administrators may not be able to qualify in time.** Users of Third Country Benchmarks are concerned that administrators who want to have their benchmarks qualify for use in the EU will not be able to do so under any of the available routes before the end of the transition period. Equivalence relies upon local regulations which may not be in place or which may only cover specific benchmarks. In this latter scenario, significant indices not covered by the relevant regulations would be unable to benefit from any equivalence decision. Their administrators therefore would need to seek compliance via recognition or endorsement. Even were they do so, there will be limited visibility as to their prospects of success. Endorsement and recognition suffer from practical issues which, for many Third Country Administrators, render them effectively inoperable.

- **Some third country benchmark administrators unlikely to apply under the EU Benchmarks Regulation.** Administrators of some third country benchmarks do not intend to apply to have their benchmarks qualified for use under any of the three available routes. The expense, complexity and potential liabilities involved in achieving such qualification are far in excess of any benefit that the administrators would accrue.

- **Potential for market disruption from prohibiting a large non-critical benchmark or many smaller benchmarks.** Each non-critical benchmark may be referenced in up to €500 billion of EU financial contracts. Prohibiting such a large non-critical benchmark and/or a significant number of smaller non-critical benchmarks at the same point in time without appropriate safeguards may pose a significant risk of market disruption. Given the absence of information on the benchmarks in question and the lack of available alternatives, market participants are unable to take informed steps to mitigate their risks.

- **Different treatment for EU-based non-critical benchmarks.** It would not be reasonable to subject EU non-critical benchmarks to the end of the transition period but to extend it for third country benchmarks. Therefore our strong request is for the extension to be provided with respect to all non-critical benchmarks.

Conclusion

The European Benchmarks Regulation has driven great advances in increasing contractual robustness for benchmarks and the contracts which reference them[5]. The provisions which have achieved these

[5] In June 2018, ISDA published the ISDA Benchmarks Supplement specifically aimed at improving contractual robustness in derivatives subject to the EU Benchmarks Regulation by providing generic fallback arrangements.

advances are already live and not impacted by any extension to the transition period. The European market place has become safer and more efficient as a result. Taking the steps recommended above in extending the transition period for critical benchmarks will ensure that this good work remains in place while further efforts are undertaken to keep pace with global benchmark reforms without introducing significant, potentially even systemic, risks associated with prohibiting the use of benchmarks.

Extending it for non-critical benchmarks will allow third countries time to work with the European Commission to ensure that sufficient equivalence determinations are in place before any prohibition takes effect. Critical and non-critical benchmarks are a vital resource for European citizens and institutions – depriving them of the ability to access them exposes them to risks that they cannot mitigate and places them at a very material commercial disadvantage.

PART 1 – THE TRANSITION PERIOD FOR CRITICAL BENCHMARKS SHOULD BE EXTENDED

Systemic threat of a discontinuation of a critical benchmark:

The possible cessation of a widely used interbank offered rate ('**IBOR**') has been flagged by the global regulatory community as posing a fundamental threat to financial stability.[6][7]

EONIA and EURIBOR have both been designated as 'critical benchmarks' under the EU Benchmarks Regulation. This was in recognition of the fact that their cessation would be likely to cause systemic risk and widespread market disruption in the EU. The Commission Implementing Regulation[8] which designated EONIA as a critical benchmark said:

> "It is the reference interest rate for interest rate swaps in euro. It is therefore crucial for the functioning of the euro swap market and financial stability in the Union."

It estimated that EONIA was referenced in over €6 trillion of secured and unsecured money market instruments and overnight interest swaps. These contracts are used by corporate entities, pension and investment funds, insurance companies, banks and other entities.

Similarly, the Commission Implementing Regulation[9], which designated EURIBOR as a critical benchmark, noted that EURIBOR is referenced in over €1 trillion of retail mortgages as well as more than €180 trillion of other contracts. Benoît Cœuré, Member of the Executive Board of the European

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It is also working on producing specific fallbacks for certain IBOR rates, including EURIBOR. Other trade associations and working groups are working on similar initiatives for other products such as loans and floating rate notes. T

[6] http://www.fsb.org/2014/07/r_140722/

[7] https://www.ecb.europa.eu/press/key/date/2018/html/ecb.sp180925.en.html

[8] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R1147&from=EN

[9] https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32016R1368&from=EN

Central Bank ('**ECB**') recently noted[10] that approximately four-fifths of lending to non-financial corporations is principally priced off EURIBOR.

The adverse effects of one or both of these benchmarks ceasing to exist are anticipated to include widespread payment failures, litigation and insolvencies, liquidity crunches and contagion risk. Given the global and interconnected nature of markets, these effects would be felt internationally as well as domestically.

Status of EONIA

The scheduled end of the transition period for the EU Benchmarks Regulation on 31 December 2019 will result in benchmarks that do not comply with the EU Benchmarks Regulation being prohibited from being used by supervised entities in the EU. The administrator of EONIA, the European Money Markets Institute ('**EMMI**'), announced that, should market conditions and dynamics remain unchanged, EONIA's compliance with the EU Benchmarks Regulation cannot be warranted and that its governing bodies have determined that pursuing a thorough EONIA review is no longer appropriate[11].

Status of EURIBOR

More positively, EMMI, which also administers EURIBOR, recently announced that its testing of a proposed hybrid methodology for EURIBOR made it confident that it could be made compliant with the EU Benchmarks Regulation[12]. The Belgian Financial Services and Markets Authority ('**FSMA**') recently commended EMMI on its work and indicated that it would attempt to expedite EMMI's application for authorisation once received[13]. EURIBOR's status post-end-2019, however, will not be assured until FMSA makes its formal determinations. FSMA has stated that it sees assurances that panel banks are operationally ready and willing to contribute under the new hybrid methodology as a pre-requisite. Given the historic reluctance of panel banks to contribute to EURIBOR, this remains a cause of uncertainty for the moment.

Prohibition on use is equivalent to cessation

Prohibition on use of a benchmark will have similar effects to those outlined above in relation to its potential cessation. While there are provisions which would allow for EONIA (and to the extent applicable, EURIBOR) to continue being used in legacy transactions, there are serious concerns as to how much this would mitigate the effects in practice if EU institutions are unable to manage their exposures on a dynamic basis going forward.

Managing the risks

In relation to the IBORs (which includes EURIBOR), the Financial Stability Board has been leading benchmark reform and transition efforts through the establishment of private-sector led risk-free rate working groups ('**RFR Working Groups**') in the United States, Europe, Japan, the United Kingdom

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[10] https://www.ecb.europa.eu/press/key/date/2018/html/ecb.sp180925.en.html

[11] https://www.emmi-benchmarks.eu/assets/files/D0030D-2018-Eonia%20review%20state%20of%20play.pdf

[12] https://www.emmi-benchmarks.eu/assets/files/D0373B-2018%20Second%20Consultation%20Hybrid%20Euribor_full.pdf

[13] https://www.ecb.europa.eu/paym/initiatives/interest_rate_benchmarks/WG_euro_risk-free_rates/shared/pdf/20181018/2018_10_18_WG_on_euro_RFR_meeting_Minutes.pdf

and Switzerland. They are each broadly pursuing 3 approaches to managing the systemic risks associated with the cessation of an IBOR. Each of these 3 approaches are wholly appropriate in preparing for the prohibition of EONIA (and, potentially EURIBOR):

(i) Adoption of alternative risk-free rates. The RFR Working Groups have identified alternative risk-free rates that can be used as an alternative to the relevant IBOR and are helping to develop products and markets based on those alternative rates that can be used as alternatives to products referencing the relevant IBOR where appropriate.

(ii) Development of robust fallbacks. The RFR Working Groups are working to help introduce robust fallbacks that can be incorporated into new products referencing the IBORs and potentially incorporated into existing contracts referencing the IBORs through voluntary amendments. To the extent possible, these aim to ensure that contracts continue to function in accordance with the parties' original intentions and minimise market disruption if an IBOR ceased to be published. Incorporation of these fallbacks into existing contracts will be feasible for some products such as derivatives but much more difficult, if not impossible, for certain cash products (including mortgages) where there is no standardised documentation solution and/or where the consent of hundreds of thousands of undisclosed parties may need to be obtained.

(iii) Amendment of existing contracts to reference alternative risk-free rates. Some of the RFR Working Groups are also considering how counterparties could voluntarily amend existing legal relationships so that products currently referenced to an IBOR instead reference the relevant alternative risk-free rate. It is expected that some market participants will agree to these types of amendments for products that are able to be amended. However, given the commercial nature of these amendments, it will be very difficult to implement even for derivatives contracts and standardised solutions are not expected. The issues discussed above regarding amendments to certain cash products (including mortgages) would continue to apply to these amendments.

These approaches, however, require that:

- First, the alternative risk-free rate must have been published. Europe's nominated alternative risk-free rate, ESTER, will be administered by the European Central Bank, who have understandably insisted they are given sufficient time to ensure that the rate is properly constituted and tested prior to publication. They do not anticipate publishing ESTER on a live basis until at latest October 2019. Until that point, there are limits to the steps that market participants can take to prepare for EONIA (or potentially EURIBOR) becoming prohibited.

- Second, once published, the alternative risk-free rate must be given sufficient time to be widely adopted by the markets. This will require infrastructure for trading and clearing derivatives to be developed; deeply liquid markets to become established, term rates based on ESTER to be specified and published for certain products that cannot reference the overnight rate, test trades to be undertaken, systems to be amended and other infrastructures to be put in place. Market participants will need to acquire full trading capabilities in the new rate. Many market participants view a threshold liquidity in swaps referencing the new rate as a key step towards transitioning. Experience in other jurisdictions, such as the United States, shows that developing such liquidity takes a lot of time and effort.

- Third, the robust fallbacks required to guard against the cessation of these benchmarks must be drafted and implemented in new and legacy transactions. The work that ISDA is doing at the request of the Financial Stability Board to develop robust fallbacks for derivatives which would apply upon the permanent cessation of certain key IBORs (including EURIBOR) is on-going and is anticipated to commence implementation for certain IBORs during 2019. However, it is unlikely to be able to make material progress with respect to a fallback for EURIBOR until such time as ESTER is published and has established a degree of liquidity. Fallbacks for cash products and other uses are being developed separately. While their timing is uncertain, they may be available before the end of 2019 for new transactions. But amending existing products so that fallbacks can be embedded into them is extremely difficult and unlikely to have been completed by the end of 2019.

The need to extend the transition period for critical benchmarks

The request for an extension does not reflect a lack of effort or commitment by the private or public sector to taking the steps necessary to transition. Instead, a combination of factors have left market participants with insufficient time to put those steps into execution. The fact that EONIA was widely expected to be reformed so as to comply with the EU Benchmarks Regulation until February 2018 meant that, unlike other jurisdictions, Europe did not have an RFR Working Group set up. These working groups constitute the principle mechanism by which the public and private sector have prepared markets to transition between benchmarks. Once convened in late February 2018, the EU RFR Working Group expeditiously identified ESTER as an alternative risk free rate and have since been implementing plans for the transition of markets from EONIA to ESTER. But ESTER is a new benchmark and not yet published. There will not be enough time between the ultimate publication of ESTER and the scheduled end of the transition period in which to complete the implementation.

Extending the transition period for critical benchmarks would have a number of crucial benefits. In May 2018, for example, the ECB released analysis[14] showing that 77% of EONIA-linked swaps were due to roll off by end-2019. If markets were able to create derivative and other products which reference the alternative risk free rate, they could be used to replace these EONIA exposures as they run off ahead of the end of 2019 and the problems posed by the prohibition of EONIA would then only have to be addressed in relation to a much smaller (albeit still significant) legacy population. But, as already stated, the timetable for publication of ESTER will not allow this to commence in time. By the latest time that ESTER will be published (October 2019), the percentage of EONIA exposure due to expire in the 3 months remaining until the end of the transition period will be much lower and trending towards zero. In other words, by that point, many more contracts will be destined to be 'legacy contracts' as at 1 January 2020 and the intractable problems outlined above will apply to a much greater proportion of the exposure.

[14] https://www.ecb.europa.eu/paym/initiatives/interest_rate_benchmarks/WG_euro_risk-free_rates/shared/pdf/20180517/2018_05_17_WG_on_euro_RFR_Item_3_1_Mapping_exercise_ECB.pdf

An extension would allow a liquid swaps market to develop and for market participants to put in place the necessary infrastructure requirements. It would also allow the EU RFR WG and various trade associations to complete their work in creating and implementing robust fallbacks.

There should be no concern that the private sector will reduce their efforts to transition during this period. In June 2018, ISDA, AFME, ICMA, SIFMA and SIFMA AMG published the results of a global survey showing that 87% of respondents were concerned about their exposure to IBORs[15]. The fear that EONIA or EURIBOR could permanently cease to be published does not diminish in the absence of a regulatory deadline given that the market that they seek to measure shows no signs of becoming more liquid and the continued reluctance of their panel banks to contribute to the rates.

The private and public sector have an immensely complicated and difficult job creating the infrastructure and momentum needed to implement transition from EONIA to ESTER and implement robust fallbacks for EURIBOR (or potentially to transition away from EURIBOR). They will need all of the additional time requested if the risks of litigation, disruption, payment failures and insolvencies are to be reduced.

PART 2 –EXTENDING THE TRANSITION PERIOD FOR THIRD COUNTRY BENCHMARKS

Impact on EU investors of uncertainties created by third country benchmarks regime.

The EU Benchmarks Regulation requires Third Country Administrators to apply to have their benchmarks rendered compliant for use in the EU by means of one of three avenues: equivalence, endorsement or recognition regime (‘**third country benchmark regime**’). Those which are not compliant by the end of 2019 will not be permitted for use by supervised entities in the EU.

There is no publicly available data to show how many benchmarks used in the EU today are not on course to qualify under the EU Benchmarks Regulation using one of these three routes, though it seems likely that the numbers would be significant. Today, the register of third country benchmarks maintained by ESMA contains no data[16] because it is only intended to show successful Third Country Administrator applications and to date there are none. While some Third Country Administrators have made public statements as to their intention to apply for approval, this general lack of visibility means that market participants have no way of knowing whether many Third Country administrators are biding their time but intend to apply under the third country benchmark regime, or have no intention of applying at all. They are therefore unable to take informed steps against an administrator failing to apply, for example, by reducing their levels of exposure to a particular benchmark.

We understand that there is concern among some Third Country Administrators who do actively wish to apply to have their benchmarks qualified for use in the EU that none of the possible routes provided by the third country benchmark regime would result in a successful application:

Equivalence.

- In some cases, third countries have indicated that they have no intention of implementing benchmark regulations which could form the basis of an equivalence decision.

[15] https://www.isda.org/a/OqrEE/IBOR-Transition-Report.pdf

[16] https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_bench_entities

- In certain other jurisdictions, the regulations which have been implemented or which are being produced relate only to a limited number of specific benchmarks (such as systemically important interest rate benchmarks). They would not therefore cover other types of benchmarks. In Japan, for example, only TIBOR is covered by relevant regulation. This means that significant Japanese equities indices such as the Nikkei 225 or TOPIX would be unable to benefit from any equivalence decision. Their administrators therefore would need to seek compliance via recognition or endorsement. Even were they do so, there will be limited visibility as to their prospects of success.

- In some instances in which an equivalence determination may be available, there does not appear to be sufficient time remaining for the European Commission to grant it in every case, particularly given the need to agree a co-operation agreement with the relevant jurisdiction.

▪ ***Recognition.*** In the absence of data on volumes, administrators who do not have EU supervised affiliates are unable to identify their member state of reference, and as such unable to proceed with a recognition application. While we understand that they may be able to use ESMA's Financial Instruments Reference Data System as evidence in support of an application, it is not clear that this would be sufficient. And while the ESAs review proposal offers a welcome simplification of the recognition process by transferring responsibility for recognition decisions to ESMA, the proposal is not expected to be adopted before the transition period is due to expire. To qualify under this route prior to the end of the transition period may be incentivizing administrators to defer applications. In addition, the responsibilities and liabilities of the required legal representative remain unclear, making it difficult to judge whether third party entities would be willing to take on the role and what their terms of engagement (including cost) might be.

▪ ***Endorsement.*** In the absence of a supervised affiliate, endorsement may require administrators to cede governance and control of their benchmark activities to a third party in the EU. Although we understand that some EU administrators intend to start offering endorsement services, it is unclear whether the costs and terms for doing so will be acceptable to administrators. Given the very pressing legislative timetable, if such services do not prove capable of ensuring third country benchmark administrators' benchmarks comply, or are not economically viable, there will not be sufficient time to rectify the issue.

The third country benchmark regime is predicated upon Third Country Administrators wanting their benchmarks to be used in the European Union. However, there are concerns that the administrators of some benchmarks do not intend to apply at all. We understand that not all administrators receive a licence fee when their benchmarks are used. Absent a strong commercial incentive, they may well be put off applying by the cost, complexity and very material potential liabilities (up to 10% of global annual turnover) they could incur for what may be quite technical or administrative infringements of the regulation.

Impact on EU users of third country benchmarks of the end of the transition period

There is no publicly available data on the level of exposure to third country benchmarks held by EU institutions, including pension and investment funds, insurance companies, corporations and banks. It is impossible therefore to quantify the impact on such entities of being unable to use such benchmarks after the end of the transition period.

It is possible, however, to get a sense of the scale of the issue by considering an example. GFMA have identified a number of rates, including crucially important spot FX benchmarks, as being in danger of non-compliance by end 2019. Their list should give an indication of the kind of issues that may be caused:

Country	Currency Code
Korea	KRW
Taiwan	TWD
Philippines	PHP
India	INR
Russia	RUB
Argentina	ARS
Nigeria	NGN
Kazakhstan	KZT

As an example, the European Commission states that with respect to India[17]:

- The EU is India's number one trading partner (13.5% of India's overall trade with the world in 2015-16), well ahead of China (10.8%), USA (9.3%), UAE (7.7%) and Saudi Arabia (4.3%).

- India is the EU's 9th trading partner in 2016 (2.2% of EU's overall trade with the world), after South Korea (2.5%) and ahead of Canada (1.9%).

- The value of EU exports to India grew from €24.2 billion in 2006 to €37.8 billion in 2016.

- The value of EU imports from India also increased from €22.6 billion in 2006 to €39.3 billion in 2016.

- Trade in services almost tripled in the past decade, increasing from €10.5billion in 2005 to €28.1 billion in 2015.

- EU investment stocks in India amounted to €51.2 billion in 2015, increasing from €44.2 billion in the previous year.

The Reserve Bank of India has announced that it will publish draft regulations covering the interest rate and FX benchmarks published by Financial Benchmark India Private Ltd (FBIL). It is not clear that these regulations will come into effect in time for an equivalence decision to be granted. If they do not become effective, for example, until the second half of 2019, an equivalence decision would need to be made in six months or less. In this scenario, it seems likely that investors would be uncertain right up to the end of the transition period as to whether FBIL's benchmarks could continue to be used in the EU. If legislative changes are required in India in order to implement the regulations, they may not become effective until after the transition period is due to end.

Unless the Indian spot FX rate qualifies for use in the EU, the impact of ending the transition period under the EU Benchmarks Regulation will be to make it hard, if not impossible, for European institutions to invest in assets denominated in rupees. This will put them at an enormous competitive disadvantage. They will also no longer be able to risk-manage their existing exposures in that currency by hedging them in the European financial markets, putting them at significant risk of market losses. Nor will they be able to easily repatriate funds held there into the EU.

To date, there has not been any indication that other benchmarks administered by Indian entities, including equity indices, such as the CNX Mid-cap and CNX NIFTY 50 (both of which EU investors use to gain or hedge exposure to the Indian equity markets – estimated above as being €51.2 billion in 2015) will be subject to equivalent regulation, meaning that EU investors will be reliant on the administrators of those benchmarks successfully applying under recognition or endorsement, which as described above, have significant practical impediments associated with them.

Multiply this scenario out across the jurisdictions relevant to the 8 referenced currencies and the scale of the problem becomes clearer. A survey by GFMA of its members in May 2018 estimates that EU counterparties accounted for 38% of global non-deliverable forward trades in Korean Won; 52% with respect to Taiwanese Dollars and 50% with respect to Philippine Pesos. If these benchmarks are not compliant at the end of the transition period, much of this volume will no longer be able to take place. Loss of this liquidity will adversely impact investors in those currencies regardless of their jurisdiction. The issue is not unique to these 8 jurisdictions and their spot FX benchmarks. Concerns exist regarding indices around the world, though the universe is unknown.

Few, if any, of these affected benchmarks have alternative rates that the markets can transition to. In the case of restricted spot FX benchmarks, local central banks have historically taken action to discourage the development or use of alternative rates out of concern about potential impact on their onshore market rates. Furthermore, use of an offshore benchmark for hedging in the NDF market would leave counterparties exposed to basis risk, i.e. the difference between the onshore and offshore rates. This means that users today are compelled to manage their risks by continuing to trade by reference to existing benchmarks. They therefore have no ability to reduce their exposure except by exiting positions in their entirety. They may also have no fallback reference rate if the benchmark is prohibited from use.

Given that a non-critical benchmark may be referenced by EU contracts with a value of up to €500 billion, the effect of prohibiting a benchmark with such a large exposure would be very considerable and may well result in market disruption, failures to pay, litigation and insolvencies.

Equally, the effect of prohibiting such a wide variety of even the (relatively) smaller benchmarks across interest rate, FX, commodities and equities markets all at once is unknown but could potentially be just as disruptive, litigious, and capable of driving payment failures and insolvencies.

The need to extend the transition period for non-critical benchmarks

The lack of data regarding the impact on Europe of allowing the transition period to expire drives our request that the end of the transition period be deferred in respect of existing non-critical benchmarks for at least 2 years. This would allow a considered approach to be adopted by the public and private sector to the issues cited in this paper without putting European institutions at a greater risk than they run in continuing to use such benchmarks (given that many are likely to comply with the IOSCO Principles for Financial Benchmarks completely or to a great extent). It would avoid putting them at a considerable competitive disadvantage when it comes to investing and managing their exposures abroad. It would also provide the European Commission with additional time in which to complete equivalence determinations; for jurisdictions that wish to become equivalent to roll out appropriate regulatory frameworks and for the ESA's review to simplify the process of applying for recognition. It would not be reasonable to subject EU non-critical benchmarks to the end of the transition period but to extend it for third country benchmarks and therefore our strong request is for the extension to be provided with respect to all non-critical benchmarks.

The EU Benchmarks Regulation has resulted in significant improvements in both contractual robustness and transparency of the risks investors undertake in using specific benchmarks. The end of the transition period should not be allowed to crystallise the very risks that inspired the regulation in the first place.

This paper has been prepared by ISDA, GFMA, FIA and EMTA based upon their understanding of the issues described as at the date of publication and is intended to promote safer and more efficient markets. It is provided for informational purposes only and no representation is made as to its accuracy or completeness. It does not constitute legal, regulatory or other advice. The positions articulated may not (and in certain instances, do not) reflect the position of all of their members.

About ISDA:

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 70 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, 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 @ISDA.

About GFMA:

The Global Financial Markets Association (GFMA) represents the common interests of the world's leading financial and capital market participants, and speaks for the industry on the most important global market issues. GFMA's mission is to provide a forum for global systemically important banks to develop policies and strategies on issues of global concern within the regulatory environment. It brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London, Brussels and Frankfurt, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, visit http://www.gfma.org.

About FIA:

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry. www.fia.org

About EMTA:

Founded in 1990, EMTA, Inc., the trade association for the Emerging Markets, is a not-for-profit corporation dedicated to promoting the orderly development of fair, efficient and transparent trading markets for Emerging Markets instruments and the integration of the Emerging Markets into the global financial marketplace. EMTA has over 180 member firms worldwide, including banks, broker-dealers, asset managers, hedge funds and other institutions active in the Emerging Markets industry.