Next Steps for the EU Benchmarks Regulation
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Opening Remarks
Scott O'Malia, CEO, ISDA

Hello everyone, and welcome to *Next Steps for the EU Benchmarks Regulation*. Thanks for joining us today for this virtual event, and thank you to all of our speakers.

The Benchmarks Regulation (BMR) has been with us for nearly three years now. The current review process offers a critical opportunity to identify and correct those parts of the regulation that are not working as intended. To create a robust, proportionate and effective regulatory regime for benchmarks used in the EU, a series of wholesale changes are now required.

Despite the need for reform, it is important to recognize what works well. The BMR requires supervised entities to maintain robust written plans setting out the actions they would take in the event a benchmark materially changes or ceases to be provided. That's a requirement that resonates strongly with ISDA, as we are now close to publishing new fallbacks for derivatives contracts that would take effect if a key interbank offered rate (IBOR) ceases publication or, in the case of LIBOR, is deemed by the UK Financial Conduct Authority to be non-representative.

These fallbacks will take the form of a supplement to the 2006 ISDA Definitions to incorporate the fallbacks into new contracts, and an accompanying protocol that will allow firms to incorporate the fallbacks into legacy non-cleared trades. The timing of the publication of these fallbacks hinges on ISDA receiving a positive business review letter from the US Department of Justice and then finalizing work with competition authorities in other jurisdictions.

Once we've heard back from the competition authorities, we will give market participants around two week's notice of the official launch date. Firms can adhere on a non-public basis during this short period so that their adherence takes effect as soon as the protocol launches. After launch, the supplement and protocol will take effect three months later. ISDA will avoid the fallbacks going live during the traditional code freeze period in December. Putting these phases together, the effective date for the fallbacks won't be before mid-January 2021.

The remainder of 2020 is set to be a busy time for benchmark reform. The fallbacks will be one of the most critical amendments ever to be made to the ISDA definitions, and we expect widespread adoption of the fallbacks protocol. US central counterparties (CCPs) are due to switch the rate used for US dollar price alignment interest (PAI) and collateral discounting from the effective federal funds rate to SOFR in mid-October. This follows the switch to €STR already completed by EU CCPs back in July. Both the switches in PAI and discounting and the implementation of fallbacks will be key milestones in the transition to alternative risk-free rates, accelerating momentum around the world.

Of course, the BMR is also a critical part of global benchmark reform efforts. Unfortunately, the very wide scope of the regulation, coupled with the prohibition of benchmarks that fail to comply, mean the regulation has the potential to create exactly the kind of disruption and uncertainty it set out to avoid. ISDA has been working closely with our members, other industry associations and EU institutions in recent months as the BMR review has progressed. We have focused on multiple areas where we believe change is needed, but I'd like to highlight two of the most important today.

First, the third-country benchmark regime, which is currently in a transition period, would mean benchmarks could qualify for use in the EU in one of three ways – equivalence, endorsement or recognition. However, equivalence only applies to a small number of benchmarks, while endorsement and recognition require non-EU administrators to cede control and governance of their benchmarks, often to EU competitors at considerable cost. If third-country benchmarks fail to qualify for use in the EU, users will be unable to access products that reference those benchmarks. This will adversely impact pension funds, insurance companies, corporations and investors that rely on products referencing third-country benchmarks for hedging and investment purposes.

The current transition period for third-country benchmarks is due to expire at the end of 2021, but we understand there is currently consideration over whether to extend the transition period to the end of 2025. This would allow the time that is needed to conduct a more holistic review than envisaged by the current targeted reform proposals, addressing the deficiencies in the third-country regime in a practical and proportionate way. We would strongly support such an extension.

Second, it is critical that parties choosing to implement fallbacks in legacy derivatives contracts do not then find those contracts subject to clearing and margining requirements under the European Market Infrastructure Regulation (EMIR). The European Supervisory Authorities recognized the need for legal certainty on this, and recent amendments to EMIR have addressed the issue for fallbacks for interest rate benchmarks. But this clarity hasn't been extended to the other benchmark types in scope of the BMR. This urgently needs to be addressed as it could discourage firms from implementing fallbacks and thereby strengthening the contractual robustness of their contracts.

Clearly, there is much work still to be done to get the BMR to where we believe it needs to be. However, we are grateful to the team at DG FISMA in the European Commission for their willingness to engage on all aspects of the regulation. We may not agree on everything, but we certainly share the aspiration for a framework that promotes the safe and efficient use of benchmarks in the EU. I am very pleased that Tilman Lüder, head of securities markets at DG FISMA, will give the keynote address later today. Having worked tirelessly on the BMR for several years, there is no better person than Tilman to cover this topic.

But to set the scene on the BMR, I'm delighted to introduce Stevi Iosif, ISDA's director of European public policy, to moderate our first panel.