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From:	Presidency
To:	Permanent Representatives' Committe (Part 2)
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Subject:	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 - Mandate for negotiations with the European Parliament

Delegations will find below the Presidency compromise text on the above-mentioned Commission proposal.

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

(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 114 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Economic and Social Committee ,

Acting in accordance with the ordinary legislative procedure,

Whereas:

(1) In order to hedge against adverse foreign exchange rate movements in currencies that are not readily convertible or subject to exchange controls, companies in the Union enter into non-deliverable currency derivatives, such as forwards and swaps. Those instruments enable their users to protect against adverse movements of foreign currencies that are not readily convertible into a base currency. The unavailability of spot foreign exchange benchmarks to calculate the pay-outs due under currency derivatives would have a negative effect on companies in the Union that export to emerging markets or hold assets or liabilities in those markets, with consequent exposure to fluctuations of emerging market currencies. Following the expiration of the transitional period set out in paragraph 5 of Article 51 of Regulation (EU) 2016/1011 of the European Parliament and of the Council , the use of spot foreign exchange benchmarks provided by a third country administrator other than a central bank will no longer be possible.

(2) In order to enable companies in the Union to continue their business activities while mitigating foreign exchange risk, certain spot foreign exchange benchmarks used in financial instruments to calculate contractual pay-outs that are designated by the Commission in accordance with certain criteria should be excluded from the scope of Regulation (EU) 2016/1011.

(3) In order to designate certain third country spot foreign exchange benchmarks as being excluded from the scope of Regulation (EU) 2016/1011, the power to adopt acts in accordance with Article 290 of the Treaty on the Functioning of the European Union should be delegated to the Commission in respect of the exemption of spot foreign exchange benchmarks for non-convertible currencies when that spot foreign exchange benchmark is used for calculating the pay-outs that arise under non-deliverable foreign exchange derivative contracts. It is of particular importance that the Commission carry out appropriate consultations during its preparatory work, including at expert level, and that those consultations be conducted in accordance with the principles laid down in the Interinstitutional Agreement of 13 April 2016 on Better Law-Making. In particular, to ensure equal participation in the preparation of delegated acts, the European Parliament and the Council receive all documents at the same time as Member States' experts, and their experts systematically have access to meetings of Commission expert groups dealing with the preparation of delegated acts.

(4) As of the end of the transition period for the United Kingdom's withdrawal from the Union on 31 December 2020, the interest rate benchmark London Interbank Offered Rate (LIBOR) will no longer qualify as a critical benchmark under Regulation (EU) 2016/1011. The UK Financial Conduct Authority (FCA) has announced that it will not persuade or compel panel banks to submit to LIBOR beyond the end of 2021 which increases the risk that one of the most important interest rate benchmarks, will most likely be wound down by the end of 2021. The winding down 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, securities and derivatives that all reference LIBOR, that mature beyond 31 December 2021 and that do not have robust contractual fallback provision to cover for the cessation of publication or winding down of LIBOR in the relevant calculated currency respectively some of its tenors. Some of those contracts and financial instruments as defined in Directive 2014/65/EU cannot be renegotiated to incorporate a contractual fallback provision prior to 31 December 2021. The cessation or winding down of LIBOR may therefore result in significant disruption in the functioning of financial markets in the Union.

(5) To be able to provide for the orderly winding down of a widely used benchmark the cessation of which may result in negative consequences that produce significant disruption in the functioning of financial markets in the Union and where such contracts or financial instruments as defined in Directive 2014/65/EU cannot be renegotiated to include a contractual fallback provision by the time of that benchmark's cessation, a framework accompanying the cessation or orderly winding down of such benchmarks should be laid down. That framework should comprise a mechanism aimed at transitioning such contracts or financial instruments as defined in Directive 2014/65/EU to designated replacement benchmarks. Replacement benchmarks should ensure avoiding contract frustration which may result in negative consequences that produce significant disruption in the functioning of financial markets in the Union.

(5a) The absence of a mechanism within this Regulation to organise the orderly winding down of a benchmark would likely result in heterogeneous legislative solutions by Member States. Hence, European stakeholders are exposed to risks from the diverging implementation of national laws. Along with the outstanding exposure and stock of contracts and financial instruments as defined in Directive 2014/65/EU, the increased likelihood of contractual frustration and the increased risk of litigation could lead to significant disruptions in the functioning of financial markets. Due to the extraordinary circumstances and systemic risks, it is necessary to establish a harmonised approach for critical benchmarks and third country benchmarks with systemic relevance for the Union. Member States competencies with regards to significant and non-significant benchmarks are not affected by this Regulation.

(6) In order to ensure uniform conditions for the implementation of this Regulation, implementing powers should be conferred on the Commission to designate a replacement benchmark to replace all references to the benchmark in cessation or being wound down in contracts or financial instruments as defined in Directive 2014/65/EU that have not been renegotiated by the date of the entry into force of the implementing act. Those powers should be exercised in accordance with Regulation (EU) No 182/2011 of the European Parliament and of the Council . Legal certainty requires that the Commission exercises those implementing powers only upon precisely defined trigger events clearly demonstrating that administration and publication of the benchmark to be replaced will cease permanently. Those powers should be conferred on the Commission for critical benchmarks under Regulation (EU) 2016/1011 and for third country benchmarks with systemic relevance for the Union.

(6a) Similar negative consequences may arise from contracts or financial instruments which are by definition outside of the scope of Regulation (EU) 2016/1011, but which reference benchmarks that are under cessation or are being wound down. In the same way, many entities use such benchmarks but do not qualify as supervised entities. Consequently, those contracts and contractual parties would not benefit from the replacement of a benchmark. In order to mitigate potential impacts on market integrity and financial stability as far as possible and to provide protection against legal uncertainty, the mandate of the Commission to designate a replacement benchmark should apply to any contract or any financial instrument as defined in Directive 2014/65/EU that is subject to the law of a Member State. In addition, the designated replacement benchmark should also apply to contracts that are subject to the law of a third country that have been entered into between contractual parties established in the Union in cases where the contract meets the requirements of this Regulation and where the law of the third country does not provide for an orderly wind down of a benchmark. This extension should not affect the remaining provisions of Regulation (EU) 1011/2016.

(6b) The replacement benchmark designated by the Commission should not apply where all parties have agreed to apply before or after the entry into force of the implementing act a different contractual fallback provision.

(7) deleted

(8) deleted

(8a) It should be incumbent on the contracting parties to analyse their private law contractual arrangement to determine which situations a contractual fallback provision intends to cover. If the interpretation of a contract or financial instrument as defined in Directive 2014/65/EU reveals that the parties did not intend to cover the permanent cessation of a chosen benchmark, the statutory replacement benchmark that is designated in accordance with the provision of this Regulation should provide a safe harbour to address the permanent cessation.

(9) The application of the replacement benchmark by operation of law should be restricted to contracts or financial instruments as defined in Directive 2014/65/EU that have not been renegotiated prior to the cessation date of the benchmark concerned. Where master contracts are used, the replacement benchmark will apply only to transactions entered into prior to the relevant replacement date, even though later transactions might technically be part of the same contracts. The use of the replacement benchmark designated by the Commission should therefore be restricted to contracts or financial instruments as defined in Directive 2014/65/EU already entered into 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 financial instruments as defined in Directive 2014/65/EU that already provide a contractual fallback provision which addresses the permanent cessation of a benchmark.

(10) Before exercising its implementing powers to designate a replacement benchmark, the Commission should conduct a public consultation and should take into account recommendations by the central bank or by private sector working groups operating under the auspices of the central bank responsible for the currency in which the interest rates of the replacement benchmark are denominated. Those recommendations should be based on extensive public consultations and expert knowledge, about the most appropriate replacement rate for the interest rate benchmark in cessation. The Commission should also take into account recommendations of other relevant stakeholders, including the competent authority of the benchmark administrator and ESMA.

(10a) Considering that the replacement of a benchmark may require essential consequential changes or modifications of those contracts necessary for the practical use or application of such replacement benchmark, the Commission should be empowered to lay down such corresponding conforming changes in the implementing act.

(11) For benchmarks which are designated by the Commission as being critical in one Member State in accordance with Regulation (EU) 2016/1011 and where the cessation or winding down of such benchmark may result in significant disruptions of the functioning of financial markets in one Member State, the relevant competent authority should take necessary actions to avoid such disruptions in accordance with national law.

(11a) Where a Member State accedes to the Euro area and where a subsequent lack of input data for computing a national benchmark requires the replacement of that benchmark, that Member State may adopt a statutory provision providing for the transition from this benchmark to a replacement benchmark. In such case, that Member State should take into account the status of consumers as contractual parties and ensure their position is not negatively affected by the transition of the benchmark to a greater extent than necessary.

(11b) It is generally acknowledged that benchmarks and their contractually agreed fallback provision may over time significantly and unexpectedly diverge from each other and, as a consequence, may neither represent the same underlying economic reality anymore nor lead to commercially acceptable results. Such cases could include the significant widening of the spread between the benchmark and the contractually agreed fallback provision over time or situations where the contractually agreed fallback provision changes the basis of the benchmark from a variable rate to a fixed rate. Since this issue might arise in a number of Member States, and frequently parties from different Member States would also be affected in such cases, it should be tackled in a harmonized way in order to avoid legal uncertainty, excessive litigation and, as a consequence, possible significant negative effects on the single market or repercussions on the financial stability in individual Member States or the Union. Accordingly, the replacement benchmark that is established by the implementing act to be adopted under this Regulation to provide for cases where there is no contractual fallback provision foreseen for cases of a permanent cessation of a critical benchmark and third country benchmarks with systemic relevance in the Union should under certain preconditions serve as a replacement benchmark after relevant national authorities, for example macro-prudential authorities, systemic risk councils or the central banks, have established that the originally agreed fallback provision no longer reflects the economic reality that the ceasing benchmark was intended to measure or could pose a threat to financial stability. The relevant national authorities involved should be obliged to inform the Commission and ESMA of said assessment.

(12) Regulation (EU) 2016/1011 should therefore be amended accordingly.

(13) In view of the fact that LIBOR will no longer be a critical benchmark within the meaning of Regulation (EU) 2016/1011 as of 1 January 2021, it is appropriate that this Regulation enters into force without delay.

HAVE ADOPTED THIS REGULATION:

Article 1

Amendments to Regulation (EU) 2016/1011

(1) Article 2 is amended as follows:

(a) the following paragraph is added:

"1a. Chapter 4a applies to:

(a) any contract or any financial instrument listed in Section C of Annex I to Directive 2014/65/EU that is governed by the laws of one of the Member States and that references a benchmark; and

(b) any contract that is subject to the law of a third country but the parties to which are all established in the Union and where the law of that third country does not provide for an orderly wind down of a benchmark."

(b) in paragraph 2, the following point (i) is added:

"(i) a spot foreign exchange benchmark which has been designated by the Commission in accordance with paragraph 5";

(c) the following paragraphs are added:

"3. The Commission can designate spot foreign exchange benchmarks that are administered by administrators located outside the Union where all of the following criteria are fulfilled:

(a) the foreign exchange benchmark refers to a spot exchange rate of a third-country currency that is not freely convertible;

(b) the spot foreign exchange benchmark is used on a frequent, systematic and regular basis to hedge against adverse foreign exchange rate movements.

(c) deleted

4. By 31 December 2024, the Commission shall conduct a public consultation to identify spot foreign exchange benchmarks that fulfil the criteria laid down in paragraph 3.

5. By 31 December 2025, the Commission shall adopt delegated acts in accordance with Article 49 of this Regulation to create a list of spot foreign exchange benchmarks that fulfil the criteria laid down in paragraph 3 of this Article. The Commission shall update the list as appropriate."

(1a) In Article 3, the following paragraph is inserted:

“(1a) For the purposes of Chapter 4a of this Regulation, ‘financial instrument’ means any of the instruments listed in Section C of Annex I to Directive 2014/65/EU.

(2) the following chapter is added:

"CHAPTER 4a

Replacement of a benchmark by legislation

Article 23a

Replacement of a benchmark by EU legislation

(1) The Commission may designate one or more replacement benchmarks for a benchmark designated as critical by an implementing act adopted in accordance with Article 20, paragraph 1(a) or 1(c) of this Regulation or a third country benchmark where the winding down or cessation of that benchmark may result in significant disruption of the functioning of financial markets in the Union, provided that any of the following events has occurred:

(a) the competent authority for the administrator of that benchmark has issued a public statement, or has published information, in which it is announced that the capability of that benchmark to measure the underlying market or economic reality cannot be restored. In the case of a critical benchmark under points (a) and (c) of Article 20 (1) of this Regulation, the above determinations shall be made by the competent authority of that critical benchmark only after the remedial powers set out in Article 23 of this Regulation have been applied without leading to the restoration of the benchmark's capability to measure the underlying market or economic reality;

(b) the administrator of a benchmark has issued a public statement, or has published information, or such public statement has been made or such information has been published on behalf of that administrator, in which it is announced that that administrator will orderly wind down the benchmark or will cease to provide the benchmark or certain tenors or certain currencies in which the benchmark is calculated, permanently or indefinitely, provided that, at the time of the issuance of the statement or the publication of the information, there is no successor administrator that will continue to provide the benchmark;

(c) the competent authority for the administrator of a benchmark or any entity with insolvency or resolution authority over the administrator of that benchmark has issued a public statement or has published information in which it is stated that the administrator of that benchmark will orderly wind down the benchmark or will cease to provide that benchmark or certain tenors or certain currencies in which the benchmark is calculated permanently or indefinitely, provided that, at the time of the issuance of the statement or the publication of the information, there is no successor administrator that will continue to provide that benchmark;

(d) the competent authority withdraws or suspends the authorization in accordance with Article 35 of this Regulation, withdraws the recognition in accordance with Article 32(8) of this Regulation or ceases the endorsement in accordance with Article 33(6) of this Regulation, provided that, at the time of the withdrawal or suspension or cessation, there is no successor administrator that will continue to provide that benchmark.

(2) The replacement benchmark shall, by law, replace all references to the benchmark in contracts and financial instruments that are subject to Article 2(1a) of this Regulation, where all of the following conditions are fulfilled:

(a) the contracts or financial instruments reference the benchmark that will cease or be wound down, on the date when the implementing act designating the replacement benchmark enters into force; and

(b) those contracts or financial instruments contain

(ba) no fallback provision or a fallback provision that does not cover the permanent cessation of a reference benchmark; or

(bb) a permanent fallback provision, provided that

(i) the relevant authority has established that the application of the contractually agreed fallback provision does generally no longer, and with significant difference, reflect the underlying market or the economic reality that the ceasing benchmark is intended to measure, and could have an adverse impact on financial stability;

(ii) following the assessment by the relevant authority in accordance with point (i), one of the parties to the contract has objected to the contractually agreed fallback provision at the latest [3 months] before the permanent cessation or winding down of the benchmark;

(iii) the contracting parties have not agreed on an alternative fallback provision following the objection pursuant to point (ii) at latest [one working day] before the permanent cessation or winding down of the benchmark.

For the purposes of point (i) of point (b)(bb), the relevant authority shall inform the Commission and ESMA of its assessment without undue delay. Where entities in more than one Member State could be affected by the assessment, the relevant authorities of all those Member States shall conduct the assessment jointly.

Member States shall designate one or more relevant authorities, which are in the position to conduct the assessment in accordance with i). Member States shall inform the Commission and ESMA of the designation of the competent authorities pursuant to this paragraph by [6 months after entry into force of this Regulation].

(3) The Commission shall adopt an implementing act to designate one or more replacement benchmarks in accordance with the examination procedure referred to in Article 50(2) where one of the conditions laid down in paragraph 1 is fulfilled.

The implementing act shall include the following elements:

(i) the replacement benchmark

(ii) the spread adjustment, including the method for determining such spread adjustment, that is to be applied to the benchmark in cessation on the date of the replacement for each particular term to account for the effects of the transition or change from the benchmark to be wound down to the replacement benchmark;

(iii) the corresponding essential conforming changes that are associated with and reasonably necessary for the use or application of a replacement benchmark;

(iv) the relevant date from which the replacement benchmark shall apply;

When adopting the implementing act, the Commission shall take into account, where available, the recommendations on the replacement benchmark, the spread adjustment and the benchmark replacement conforming changes made by the central bank responsible for the currency area in which the relevant benchmark which is to be wound down, or by the alternative reference rate working group operating under the auspices of the central bank. Before adopting the implementing act the Commission shall conduct a public consultation and shall take into account the recommendations of other relevant stakeholders, including the competent authority of the benchmark administrator and ESMA.

(4) Notwithstanding the provisions of Article 23a (2) (b)(bb) of this Regulation, the replacement benchmark designated by the Commission in accordance with paragraph 1 shall not apply where all parties or the required majority of a contract or financial instrument that is subject to Article 2(1a) of this Regulation have agreed to apply a different replacement benchmark before or after the entry into force of the implementing act.

Article 23b – Replacement of a benchmark by national legislation

(1) The Member State, where the majority of contributors is located, may designate one or more replacement benchmarks for a benchmark under Article 20 (1)(b) of this Regulation, provided that any of the following events has occurred:

(a) the competent authority for the administrator of that benchmark has issued a public statement, or has published information, in which it is announced that the capability of that benchmark to measure the underlying market or economic reality cannot be restored and that the remedial powers set out in Article 23 of this Regulation have been applied without leading to the restoration of the benchmark's capability to measure the underlying market or economic reality;

(b) the administrator of a benchmark has issued a public statement, or has published information, or such public statement has been made or such information has been published on behalf of that administrator, in which it is announced that that administrator will orderly wind down the benchmark or will cease to provide the benchmark or certain tenors of the benchmark or certain currencies in which the benchmark is calculated, permanently or indefinitely, provided that, at the time of the issuance of the statement or the publication of the information, there is no successor administrator that will continue to provide the benchmark;

(c) the competent authority for the administrator of a benchmark or any entity with insolvency or resolution authority over the administrator of that benchmark has issued a public statement or has published information in which it is stated that the administrator of that benchmark will orderly wind down or will cease to provide that benchmark or certain tenors or certain currencies in which the benchmark is calculated permanently or indefinitely, provided that, at the time of the issuance of the statement or the publication of the information, there is no successor administrator that will continue to provide that benchmark or

(d) the competent authority withdraws the authorization of the benchmark administrator according to Article 35 of this Regulation, provided that, at the time of the withdrawal or suspension there is no successor administrator that will continue to provide that benchmark.

(2) Where a Member State designates one or more replacement benchmarks in accordance with paragraph 1, the competent authority of that Member State shall immediately notify ESMA.

(3) The replacement benchmark shall, by law, replace all references to the benchmark in contracts and financial instruments that are subject to Article 2 (1a) of this Regulation where all of the following conditions are fulfilled:

(a) the contracts or financial instruments reference the benchmark that will cease or has ceased to be published on the date when the national legislation designating the replacement benchmark enters into force; and

(b) those contracts or financial instruments contain no fallback provision or contain a fallback provision which does not cover the permanent cessation of a reference benchmark.

(4) The replacement benchmark designated by the Member State or competent authority in accordance with paragraph 1 shall not apply where all parties or the required majority of a contract or financial instrument that is subject to Article 2(1a) of this Regulation have agreed to apply a different replacement benchmark before or after the entry into force of the national provision.";

(3) in Article 29 the following paragraph is inserted:

"1a. A supervised entity may also use a benchmark in the Union if the benchmark is designated by the Commission or, in case of Art. 23b, by a Member State, in accordance with the procedure set out in Chapter 4a and only applicable to those financial instruments, financial contracts and measurements of the performance of an investment fund which fulfil the requirements in Chapter 4a of this Regulation."

(4) the Article 49 is amended as follows:

(a) the following paragraph is inserted:

(2b) The power to adopt delegated acts referred to in Article 2(5) shall be conferred on the Commission for an indeterminate period of time from [JANUARY 2021].

(b) paragraph 3 is replaced by the following:

"3. The delegation of power referred to in Articles 2(5), 3(2), 13(2a), 19a(2), 19c(1), 20(6), 24(2), 27(2b), 30(2a), 30(3a), 33(7), 48i(10), 48l(3), 51(6) and 54(3) may be revoked at any time by the European Parliament or by the Council. A decision to revoke shall put an end to the delegation of power specified in that decision. It shall take effect on the day following the publication of the decision in the Official Journal of the European Union or on a later date specified therein. It shall not affect the validity of any delegated acts already in force.

(c) paragraph 6 is replaced by the following:

"6. A delegated act adopted pursuant to Article 2(5), 3(2), 13(2a), 19a(2), 19c(1), 20(6), 24(2), 27(2b), 30(2a), 30(3a), 33(7), 48i(10), 48l(3), 51(6) or 54(3) shall enter into force only if no objection has been expressed either by the European Parliament or by the Council within a period of three months of notification of that act to the European Parliament and to the Council or if, before the expiry of that period, the European Parliament and the Council have both informed the Commission that they will not object. That period shall be extended by three months at the initiative of the European Parliament or of the Council.";

(5) in Article 51, paragraph 5 is replaced as follows:

“5. Unless the Commission has adopted an equivalence decision as referred to in Article 30(2) or (3) or unless an administrator has been recognised pursuant to Article 32, or a benchmark has been endorsed pursuant to Article 33, the use in the Union by supervised entities of a benchmark provided by an administrator located in a third country where the benchmark is already used in the Union as a reference for financial instruments, financial contracts, or for measuring the performance of an investment fund, shall be permitted only for such financial instruments, financial contracts and measurements of the performance of an investment fund that already reference the benchmark in the Union on, or which add a reference to such benchmark prior to, 31 December 2025.";

(6) in Article 54, the following paragraph is added:

"7. By 31 December 2027, the Commission shall review the functioning of the exemptions laid down in Article 2(2)(i).".

Article 2

This Regulation shall enter into force on the day following that of its publication in the Official Journal of the European Union.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the European Parliament — For the Council

The President — The President