Deutsches Aktieninstitut

The Case for Extending the Transitional Period for the Use of Third Country Benchmarks in the EU

Avoiding Negative Impact on Non-Financial Companies in the EU

Position paper on „third country benchmarks“, provided for the trialogues on amending regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks, 29 January 2019

Potentially broad impact of the Benchmark Regulation – also for non-financial companies

This position paper of Deutsches Aktieninstitut[1] summarises the rising concerns among non-financial companies about the possible negative impact of the EU Benchmark Regulation on doing business.

As of 1 January 2020, the EU Benchmark Regulation (BMR) will prohibit the use of non-compliant benchmarks on interest rates, currencies, equities and commodity prices in financial instruments. Though the use of non-compliant benchmarks will only be prohibited for regulated entities (e.g. banks, investment firms), their clients from the non-financial sector may also be negatively affected. For example, clients may use financial instruments to hedge against interest rate, exchange rate or commodity price risks related to their operative business, they may have entered into debt contracts or swaps referencing to interest rate benchmarks or they may wish to hedge assets of pension funds against stock price downturns. Such services or hedging activities will become impossible to offer for EU banks if the respective benchmark is non-compliant.

The possible impact may be broad, because the spectrum of benchmarks is also very broad. Not only “critical benchmarks” (such as the EURIBOR and EONIA) are in scope of the BMR but any reference value provided by an EU or non-EU administrator.

The “law carbon benchmark” file should extent transitional periods

We therefore appreciate that, in relation to critical benchmarks, policymakers are about to amend the transitional provision of Art. 51. Both the Council’s as well as the European Parliament’s positon on the “low carbon benchmark” file give market participants more time (until 31 December 2021) to adjust to the new regime. The background of the proposed amendments is the concern that EURIBOR could fail to comply with the BMR in due time and market participants may not be able to adjust to ESTER – the alternative ECB benchmark. **We therefore encourage the legislator to agree on the extension of the transitional period.**

However, the current proposal will not apply to benchmarks administered in non-EU jurisdictions. Even though such third country benchmarks may not be of

[1] Deutsches Aktieninstitut (EU transparency register: 38064081304-25) represents the entire German economy interested in the capital markets. The about 200 members of Deutsches Aktieninstitut are listed companies, banks, stock exchanges, investors and other important market participants. This position paper is based on discussions in the corporate finance/corporate treasury working group which is the central forum of opinion building for the treasury departments of the biggest German non-financial companies in Germany.

paramount importance for the EU capital markets as a whole, they can be very important from the perspective of non-financial companies with operative business in these jurisdictions or in other circumstances.

For example, it is fully uncertain whether and to what extent non-financial companies will be able to hedge against currency risks in Korean or Indian currency. For the hedging of exports from, and imports to, a number of countries, non-financial companies depend on certain derivatives (so called non deliverable forwards (NDFs)) which reference third country benchmarks as there are no other options to hedge these currencies. For the two countries above, the volume of export and imports amounted to roughly 200bn Euros in 2017 according to Eurostat statistics. This alone shows that the problem is significant.

It should be furthermore noted that this is only one example where the BMR can result in significant negative impact. An additional problem may be **internal finance for corporate subsidiaries** which is often provided by the central treasury unit in the EU. To convert Euro funds into the respective local currency the central treasury uses cross-currency-swaps referencing a local interest rate benchmark, e.g. from EUR to Renminbi (SHIBOR) or Rubel (MOIBOR). **The inherent interest rate risk will be hedged by the central treasury unit also using hedging instruments referencing to that third country benchmark.** Rendering these benchmarks unavailable would counteract the central treasury logic by requiring local subsidiaries to finance themselves externally.

Extending transitional periods also for third country benchmarks

Overall, only one year before the BMR will be fully in force, there is a high level of uncertainty among non-financial companies and their counterparties in the financial sector, whether and which financial instruments and services referencing to non-EU benchmarks will be possible as of 1 January 2020. Even worse, it is not possible to get reliable information on whether administrators are working actively towards any of the three options of the BMR (equivalence decision, registration, endorsement) that would ensure a continued use of non-EU benchmarks in the EU. As a consequence, non-financial companies are not able to adjust to the upcoming status quo in due time.

Against this background, the transitional period should not only be extended for critical benchmarks but also for non-critical and non-EU benchmarks, so that market participants get more time to adjust. The trialogues on the “low carbon benchmark” file offer a perfect opportunity to amend the BMR in this respect.

We therefore will be most grateful if our position is supported. The amendment to the BMR could follow the proposal provided by Anne Sander in the drafting phase of the European Parliament’s report (see amendment no. 156).

Notwithstanding the issue of a smoother transition, legislators should also work on an improved permanent solution for non-EU benchmarks than is currently provided by the three existing third-country options of the BMR, so that it will be easier to ensure their use in the EU. At least currently, it appears that non-financial companies in the EU will be less able to use benchmark-related hedging instruments than their non-EU competitors. This negative impact should be avoided on a permanent basis.

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