Deutsches Aktieninstitut

Adjusting the Benchmark Regulation

Removing Barriers and Avoiding Negative Impact on Non-Financial Companies in the EU

Response of Deutsches Aktieninstitut to the public consultation on the Review of the EU Benchmark Regulation, 18 December 2019

Introduction

Deutsches Aktieninstitut[1] appreciates the opportunity to respond to the EU Commission's consultation on the review of the EU Benchmark Regulation.

This position paper summarizes the view of German non-financial companies on the issues raised. Our view is based on discussions in the corporate finance/corporate treasury working group of Deutsches Aktieninstitut which is the central forum of opinion building for the treasury departments of the largest German non-financial companies (NFC).

We appreciate that the consultation paper touches the important issue of the regime on third country benchmarks which has raised particular concerns among non-financial companies. Deutsches Aktieninstitut thus encourages the EU Commission to develop a permanent regime with regard to Non-EU-Benchmarks allowing for a constant use in the EU without setting too high requirements for administrators outside EU. Otherwise, the regulation may have concrete effects on the operational business - with the consequence that EU companies may face a competitive disadvantage vis-à-vis international competitors operating in less strict regime on benchmarks.

[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.

1 Critical Benchmarks

Question 1: To what extent do you think it could be useful for a competent authority to have broader powers to require the administrator to change the methodology of a critical benchmark?

Unregulated and unexpected expiration or the prohibition of benchmarks has far-reaching consequences for capital markets. The aim of a competent authority should be to avert negative effects of such cases.

In this context, it could be useful for a competent authority to have broader powers to require the administrator to change the methodology of a critical benchmark. From our point of view, it is better to instruct an adjustment for the benchmark calculation and maintain benchmarks, then to lose an important anchor point for many financial contracts. For non-financial companies in particular, changeovers are costly and time-consuming.

Question 2: Do you consider that such corrective powers should apply to critical benchmarks at all stages in their existence or should these powers be confined to (1) situations when a contributor notifies its intention to cease contributions or (2) situations in which mandatory administration and/or contributions of a critical benchmark are triggered?

The powers should apply only in cases (1) and (2). It is not necessary to adapt a benchmark that already meets all the requirements.

2 Orderly cessation of a critical Benchmark

Question 4: To what extent do you think that benchmark cessation plans should be approved by national competent regulators?

Administrative overkill should be avoided as well as getting too many regulators involved (EU central regulator is sufficient from our point of view). Question is what would happen should the regulator not approve? How could they refuse if cessation is one of two viable option for administrators?

Question 5: Do you consider that supervised entities should draw up contingency plans to cover instances where a critical benchmark ceases to be representative of its underlying market?

Contingency plans are vital. But according to the BMR, Supervised Entities are already required to produce and maintain written plans for cessation or material changes of a benchmark, setting out the actions they would take. We think that additional regulation is not necessary.

3 Authorisation, suspension and withdrawal

Question 7: Do you consider that it is currently unclear whether a competent authority has the powers to withdraw or suspend the authorisation or registration of an administrator in respect of one or more benchmarks only?

Currently, the regulation focusses on administrator level, but obviously the focus should be on each individual benchmark, because this is what is actually being used. Compliant benchmarks should not become victim to non-compliant "sister" benchmarks. Discontinuing potentially hundreds of benchmarks because of individual non-compliant ones would be unnecessarily disruptive. If, for example, a benchmark offered by a large provider like Bloomberg or WMR Reuters loses its authorization, it would not be appropriate to ban the remaining compliant benchmarks as well. This could have unpredictable consequences, especially for end-users.

Question 8: Do you consider that the current powers of NCAs to allow the continued provision and use in existing contracts for a benchmark for which the authorisation has been suspended are sufficient?

The use of non-compliant benchmarks should be allowed in all legacy contracts, irrespective of whether the respective benchmark is classified as critical, significant and non-significant and irrespective of whether authorization has been suspended or withdrawn. Furthermore, the regime should not only provide for a solution for legacy contracts but also for sufficient transitional periods in case an authorization is finally withdrawn. After a prohibition of a benchmark a multitude of contracts, processes and systems needs to be assessed and alternatives to existing benchmarks need to be evaluated (if not developed). Thus, after any supervisory action that leads to a cessation of a benchmark sufficient time to adjust should be providedto users of financial products..

Such a broader regime increases planning security and avoids market collapse and/or legal disputes between market participants.

This is particularly important for non-financial-companies that, for example, use financial instruments to hedge against interest rates or commodity price risks related to their operative business. Furthermore, they may have entered into debt contracts or swaps referencing interest rate benchmarks or they may wish to hedge

assets of pension funds against stock price downturns. Such contracts prove particular hard to change

Question 9: Do you consider that the powers of competent authorities to permit continued use of a benchmark when cessation of that benchmark would result in contract frustration are appropriate?

See Q 8.

From the users' perspective the possibility to suspend or to withdraw the authorisation of an administrator or to prohibit the use of a benchmarks creates a number of potential risks of which the frustration of existing contracts is one of the most important ones. Another risk is that users may not be able to react fast enough to the new situation, because alternative benchmarks are missing, documentation needs to be reviewed or IT systems need to be adapted.

Overall, the BMR review should be used to minimize those kind of risks for non-financial companies. In general that means a) that legacy contracts should be protected against supervisory action as far as possible and b) realistic and sufficient transition periods should be granted to allow the negotiation of new contracts.

4 SCOPE OF THE BMR

Question 10: Do you consider that the regulatory framework applying to non-significant benchmarks is adequately calibrated? Which adjustments would you recommend?

The EU Commission rightly states the EU Benchmark Regulation appears to be unique in international comparison. Other countries tend to limit regulation to critical benchmarks of systemic importance. Against this background the EU should seek ways to reduce the burden for administrators of both significant and non-significant benchmarks. The same applies for third country benchmarks that, from an EU perspective, will regularly be not critical.

At least for the latter the mechanism of approval should be turned around: Third country benchmarks should be allowed to be used in the EU unless they are explicitly prohibited by supervisory authorities on the grounds of (still to be defined) fixed criteria. By contrast, the current principle prohibits the use of third country Benchmarks as long as they have not authorised (see Q 24).

Question 11: Do you consider quantitative thresholds to be appropriate tools for the establishment of categories of benchmarks (non-significant, significant, critical benchmarks). If applicable, which alternative methodology or combination of methodologies would you favour?

Obviously volume is the most intuitive way to establish the categories, however we are unsure whether this is always appropriate tool for establishing a benchmark category. For example, it is possible that a high-volume benchmark is only used by a very small number of professional counterparties. One example of this is are tailor-made indices.

It may be worth considering whether some benchmarks like currency fixings (used, for example, as a reference in non-deliverable forwards) could be non-critical despite a high volume. The Rationale behind this would be the high liquidity in the market, which makes them less prone to manipulation. Therefore share of observable market prices in the fixing methodology could also determine which benchmarks should be regulated more/less strictly.

5 ESMA REGISTER OF ADMINISTRATORS AND BENCHMARKS

Question 14: To what extent are you satisfied with your overall experience with the ESMA register for benchmarks and administrators? If not, how could the register be improved?

From the perspective of non-financial companies the ESMA Register leaves a lot to be desired. The register does not list the benchmarks provided by EU-authorised or registered administrators, which renders the identification of authorised or registered benchmarks for use in the Union challenging.

Question 15: Do you consider that, for administrators authorised or registered in the EU, the register should list benchmarks instead of/in addition to administrators?

It should be possible to find a benchmark in the register directly when picking one. It doesn't help much to know that an administrator provides benchmarks when you can't see wich ones they are.

6 NON-EEA BENCHMARKS

Question 23: To what extent would the potential issues in relation to FX forwards affect you? If so, how would you propose to address these potential issues?

The EU Commission rightly picks up the very important issue of FX spot rates and Non-Deliverable Forwards (NDFs). NDFs are used by non-financial companies to hedge against foreign exchange risks in currencies that are not freely convertible into Euro. Examples for such jurisdictions are India, South Korea, Argentina or Russia. As most of the NDFs are based in FX spot rates issued/calculated by organisations located in the respective third countries there are regularly no broadly used alternative rates. At the end of 2021, when the BMR transnational period expires, FX spot rates may no longer be eligible as a reference rate leading to significant problems in the management of currency risks resulting from exports or imports of non-financial companies. An exemption for third country organizations administering FX spot rates, would thus allow EU companies to continue to risk manage their existing and future exposures and investments.

However, the third country issue is not limited to FX benchmarks but also for interest rate (e.g. for Russia or Turkey), equity and other benchmarks administrated outside the EU. An example relating to interest rate benchmarks is the following: Internal funding for corporate subsidiaries 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 non-EU interest rate benchmark. 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.

Against this background, Deutsches Aktieninstitut encourages the EU Commission to develop a permanent regime with regard to Non-EU-Benchmarks allowing for a constant use in the EU without setting too high requirements for administrators outside EU. Otherwise, the regulation may have concrete effects on the operational business - with the consequence that EU companies may face a competitive disadvantage vis-à-vis international competitors operating in less strict regime on benchmarks.

In general a similar problem applies for significant and non-significant benchmarks provided by EU administrators (e.g. interest rates benchmarks for Non-Euro countries in the EU) as the transition period will expire at the end of 2019, so that it

appears to be possible that at least some of the administrators might not comply with the BMR at this point of time.

Question 24: What improvements in the above procedures do you recommend?

As stated in Question 23, the current BMR third country regime is likely to have a significant negative impact on non-financial companies if the use of non-EU benchmarks is not explicitly permitted from 1 January 2022.. Since it is unclear which benchmarks will be definitively excluded from use and which are likely to receive the approval of the competent authorities , market participants are confronted with a high degree of uncertainty as to whether and which financial instruments and services referencing to non-EU benchmarks will be possible in the future. .

From the perspective of a non-financial end-user of financial products this situation is likely to lead to uncertainties in operative business and interfering with existing treasury activities. Against this background, we strongly encourage the EU Commission to develop a regime for third country benchmarks that is reliable, transparent and avoids heavy negative impact as far as possible.

In our view a good starting point for further debates could be to turn around the logic of the current system. More specifically:

- Third country benchmarks should generally be permitted to be used in the EU as long as they are not explicitly prohibited. In such a system, it would be up to the competent authorities to identify Non-EU-benchmarks which are considered to be so critical and so prone to manipulation that some extraterritoriality might be justified. However, for the majority of Non-EU-Benchmarks the continued use in the EU should be guaranteed under such a regime.

- As for the EU benchmarks (see Q 8) the regime shift should also provide for sufficient safeguards if a third country benchmark is prohibited by a competent EU authority. First, legacy contracts should be protected against supervisory action in order to avoid market disturbances. Second, new contracts relating to non-qualified benchmarks should also be possible for a realistic and sufficient period of time in order to allow market participants time to adapt to the decision of the supervisory authorities.

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