



Brussels, 24.7.2020
SWD(2020) 143 final

COMMISSION STAFF WORKING DOCUMENT
EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT REPORT

Accompanying the document

**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**

{COM(2020) 337 final} - {SEC(2020) 284 final} - {SWD(2020) 142 final}

Executive Summary Sheet (Max 2 pages)
Impact assessment on the reform of the EU Benchmark Regulation (BMR)
A. Need for action
What is the problem and why is it a problem at EU level?
<p>First, the IA scrutinises the consequences of the lack in the BMR of regulatory powers to ensure a smooth transition away from a critical benchmark (in this instance, the London Interbank Offered Rate or “LIBOR” which is expected to cease by the end of 2021). The value of the stock of legacy contracts that will reference USD LIBOR at its cessation date is estimated in 8-12 trillion USD worldwide (much of it on the balance sheets of banks in all Member states). In the absence of a designated successor rate there is a high risk that those contracts may be frustrated. Second, the IA assesses the consequences of the BMR for European players using foreign currency spot rates to protect themselves (hedge) from changes in exchange rates. Given that many spot rates are expected not to meet BMR requirements for use in the EU, European banks will no longer offer hedging contracts linked to them to European exporters and investors.</p>
What should be achieved?
<p>The initiative aims to introduce: (i) new statutory BMR powers to enable benchmark regulators to mandate a time-limited replacement rate for a critical benchmark being wound down, such as LIBOR, to be used in existing contracts; (ii) a targeted exemption from BMR for certain currency spot rates.</p>
What is the value added of action at the EU level (subsidiarity)?
<p>Banks in all EU Member States have contracts referencing critical benchmarks on their balance sheets. Action at Member State level would require national legislators to agree on a single and uniform replacement rate. Action at national level would not be sufficient to ensure the continuous use of foreign currency spot rates as such rates are already covered by regulation adopted at EU level (BMR).</p>
B. Solutions
What are the various options to achieve the objectives? Is there a preferred option or not? If not, why?
<p>The preferred option for critical benchmarks is to mandate the administrator of a disappearing rate with the publication of a time-limited replacement rate for all references in contracts maturing after the cessation date. Another option would be to leave the design of a successor rate to the market and provide for a simplified authorisation for such a rate. A third option would be to exempt any privately designed successor rate for a limited period from BMR compliance. A fourth option would be to mandate a permanent successor rate that would serve both for existing and new contracts. The preferred option for allowing continuous use of currency spot rates is to exempt certain Commission-designated public policy rates from the BMR. Another option is to grant the Commission the power to designate “critical” third country rates (to be subject to BMR rules). Two more options would, respectively, authorise or exempt from BMR derivative contracts referencing rates entered for hedging from currency risk.</p>
What are different stakeholders' views? Who supports which option?
<p>European banks fear that, in the absence of a single successor rate of a phased-out critical benchmark, contract counterparts will cease payments, e.g., on their loans (contract frustration). In a worst-case</p>

<p>scenario, banks fear that counterparts will simply terminate the contracts. Benchmark administrators are reticent to publish a successor rate for a phased-out critical benchmark of their own volition. They fear that without a regulatory mandate, the switch to such a successor rate might become the subject of litigation. European users of currency rates have shown support for the exemption of currency spot rates from the scope of the BMR. They would also be favourable to having a designation approach.</p>
<p>C. Impacts of the preferred option</p>
<p>What are the benefits of the preferred option (if any, otherwise of main ones)?</p>
<p>The preferred option scores best in providing contract continuity and avoiding contract frustration or early termination. A time-limited “legacy” rate instantly replaces the discontinued LIBOR rate, and bears the exact same trade name. All other options would not automatically replace all contractual references to LIBOR. Equally, the preferred option for currency spot rate scores best in terms of allowing to continue hedging corporates’ exchange rate exposure and of efficiency and coherence of the regulatory regime.</p>
<p>What are the costs of the preferred option (if any, otherwise of main ones)?</p>
<p>The preferred option for critical benchmarks is cost efficient as the successor rate would be mandated by the competent authority by reference to a rate assembled based on a risk free rate that is published by the US Federal Reserve. The license fee for such a formula-based legacy rate is expected to be low. Also in the case of currency spot rates, the choice of a general policy rate exemption would not bring about costs for European entities, as they would not need to apply for any authorisation or seek <i>ad hoc</i> exemption.</p>
<p>What are the impacts on SMEs and competitiveness?</p>
<p>LIBOR plays a crucial role in SME financing. The disappearance of LIBOR without an appropriate successor rate would cause legal uncertainty. Equally, SMEs do business in third countries and they need to continue hedge their business with European counterparties. Non-action would be highly detrimental for SME businesses, especially when the COVID 19 crisis is putting at risk their very survival.</p>
<p>Will there be significant impacts on national budgets and administrations?</p>
<p>There will be no impact. Supervision of legacy rates and non-EU policy rates will be less resource-intense</p>
<p>Will there be other significant impacts?</p>
<p>The changes would also address potential cessation of critical benchmarks in the future (e.g. EURIBOR).</p>
<p>Proportionality?</p>
<p>The intended intervention is the minimum necessary to ensure contract robustness beyond the cessation of LIBOR and currency spot rates usage. All alternatives would be more complex.</p>
<p>D. Follow up</p>
<p>When will the policy be reviewed?</p>
<p>The legacy rate will be published for 5 years. After that period, the regulator will assess whether the stock of legacy contracts has been reduced to an extent that allows cessation of the rate. The policy rate exemption will be reviewed every 5 years, as required by BMR. It will be assessed whether EU-based derivative contracts are suitable as hedging tools for EU businesses’ exchange rate exposures.</p>

