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European Commission

INCEPTION IMPACT ASSESSMENT

Inception Impact Assessments aim to inform citizens and stakeholders about the Commission's plans in order to allow them to provide feedback on the intended initiative and to participate effectively in future consultation activities. Citizens and stakeholders are in particular invited to provide views on the Commission's understanding of the problem and possible solutions and to make available any relevant information that they may have, including on possible impacts of the different options.

TITLE OF THE INITIATIVE	*Review of the Benchmark Regulation*
LEAD DG (RESPONSIBLE UNIT)	DG FISMA, Unit C3
LIKELY TYPE OF INITIATIVE	*Regulation amending Regulation (EU) 2016/1011 ("The Benchmark Regulation")*
INDICATIVE PLANNING	*Q3 2020*
ADDITIONAL INFORMATION	https://ec.europa.eu/info/law/benchmarks-regulation-eu-2016-1011_en

The Inception Impact Assessment is provided for information purposes only. It does not prejudge the final decision of the Commission on whether this initiative will be pursued or on its final content. All elements of the initiative described by the Inception impact assessment, including its timing, are subject to change.

A. Context, Problem definition and Subsidiarity Check

Context [max 10 lines]

Regulation (EU) 2016/1011 (the Benchmark Regulation / BMR) entered into application on 1 January 2018, with its final transitional period expiring on 1 January 2022 (for critical and third country benchmarks). It was amended by two targeted legislative initiatives in 2019 (ESAs review and Climate Benchmarks Regulation).

Financial benchmarks are used widely throughout the financial sector and the real economy to measure markets, to hedge risks and to create investment exposure. Historically, panel-based interest rate benchmarks such as LIBOR (London Interbank Offered Rate) and EURIBOR (Euro Interbank Offered Rate) were used most widely, with total exposures in the hundreds of trillions. The main reason to amend the BMR urgently is that a transition from these IBOR rates is happening more quickly and on a more fundamental level than was anticipated. The Commission, together with the European Central Bank is closely involved in this process, which has repercussions throughout the economy, e.g., on prudential aspects, accounting, clearing, bank funding, etc. Finally, in the framework of the initiative on the International Role of the Euro, the Commission seeks to promote the use of high-quality euro-denominated benchmarks.

Problem the initiative aims to tackle [max 20 lines]

The transition from IBOR panel bank rates to risk-free rates published by central banks (named thus because they measure only the interest rate, not the credit risk that is inherent in an IBOR rate as a measure of bank funding cost) requires urgent amendments to the BMR. In order to accompany this process, it is essential that regulators have adequate tools to guide and accommodate the transition avoiding contract frustration and financial instability.

Other issues linked to the scope of the BMR and non-EU indices also require some targeted BMR amendments.

Urgent issue 1: Transition from panel-based critical interest rate benchmarks to risk-free rates published by central banks

The BMR leaves regulators ill-equipped to accompany several scenarios that will arise as part of the transition of critical benchmarks from panel bank rates to risk-free rates published by central banks. For example, we anticipate that certain IBORs will cease to be published before all **legacy contracts** are renegotiated to refer to a new replacement rate, especially in view of the number of non-standardised, purely bilateral contracts (e.g., business loans or retail mortgages), which makes it impracticable to solicit consent for contract amendment . An additional scenario would be that an IBOR ceases to be published before an **alternative (fall-back) rate** based on the risk-free rate becomes available, or before the precise mode of transition has been agreed. In order to accompany various IBOR phase-out scenarios, regulators need more extensive and finely graduated powers to monitor and accompany the industry-led IBOR transition process, and to intervene in it if there should be a market failure.

Urgent issue 2: Ensuring a level playing field / international perspectives

The equivalence regime as drafted in the BMR assumes that other jurisdictions would establish broad regulation for the provision and use of benchmarks. Instead, a majority of third countries have opted for a designation approach, regulating only the most systemically relevant benchmarks. In consequence, equivalence is only available for a limited subset of third country benchmarks. As the BMR's alternative access routes that require the initiative of the benchmark's administrator (individual recognition and endorsement by a regulated entity in the EU) have not proven successful, EU benchmark users risk losing access to a number of non-EU benchmarks on which they depend e.g., to hedge exposure to changes in interest rates or foreign exchange rates. Portfolio managers, in turn, risk losing access to specialised investment strategy indices administered outside the EU.

Efficiency and proportionality of the regime

As regards efficiency and proportionality, the Commission's public consultation has yielded clear indications of where the BMR regime might be improved, such as modifications to increase transparency on authorisations granted and user-friendliness on how many (and which) benchmarks are covered in an administrator authorisation.

Basis for EU intervention (legal basis and subsidiarity check) [max 10 lines]

The legal basis for this EU initiative is Article 114 of the Treaty on the Functioning of the European Union (TFEU).

The aim of EU action is to improve the functioning of the internal market.

This initiative falls in the domain of **already harmonised regulation** and it does fulfil the necessity and EU-added value tests of subsidiarity.

Necessity test: the above problems cannot be solved by the Member States acting alone, since it relates to adjustments to an area where existing legislation is already harmonised at the EU level (EU BMR). Furthermore un-coordinated initiatives at local level to address the transition could provoke market fragmentation issues.

EU added-value test: Coordinated action to equip EU competent authorities with the tools necessary to organise the transition to IBOR replacement rates is necessary to protect the interest of economies and citizens alike. Similarly, the treatment of benchmarks administered in third-countries must be tackled at EU level.

B. Objectives and Policy options

Under the status quo, there is a significant risk of the IBOR transition process resulting in the cessation of a critical benchmark without a replacement rate in place or without a solution for legacy contacts that continue to reference the old IBOR rate. The BMR currently does not grant customised powers to ensure the orderly transition from a critical benchmark to a replacement rate. Indeed, competent authorities may at one point decide to withdraw the authorisation for a critical benchmark and order its administrator to stop publishing it. Without accompanying measures, this could result in a risk to financial stability and in investor detriment.

In addition, the third country regime provided by the BMR has had the unexpected effect of creating a risk of EU investors and businesses losing access to a number of non-EU benchmarks on which they depend e.g., to hedge exposure to interest rate or FX risk in their daily business. Portfolio managers, in turn, risk losing access to specialised strategy indices administered outside the EU.

The **objectives** of this initiative are:

- To equip competent authorities with supervisory powers to ensure the orderly cessation of a critical benchmark, including the power to mandate the continued provision of a critical benchmark using a different methodology or the provision replacement rate;
- To ensure the continued availability to EU users of third country benchmarks for which no suitable alternative exists in the Union.

Since both of the issues outlined above are a result of the current drafting of the BMR, the only available option would most likely be to amend the L1 text of the BMR.

C. Preliminary Assessment of Expected Impacts

Likely economic impacts

The initiative would aim at mitigating the financial stability risk posed by the cessation of a critical benchmark, to which all major EU banks and many other economic actors are exposed. The initiative would ensure the competitiveness of the EU financial sector that needs to use foreign interest rate or FX indices to hedge portfolio exposures.

Likely social impacts

This initiative is not expected to have any direct social impacts.

Likely environmental impacts

This initiative is not expected to have any direct environmental impacts.

Likely impacts on fundamental rights

This initiative is not expected to have any direct impact on fundamental rights.

Likely impacts on simplification and/or administrative burden

Based on feedback received during the Q4 2019 public consultation, the initiative will make targeted amendments to the existing regime to reduce the burden on administrators of benchmarks that are less susceptible to manipulation and to improve the user-friendliness of the regime for benchmark users. In addition, the initiative aims to avoid the cliff edge effects of third country benchmarks ceasing to be available for EU users' hedging and investment needs.

D. Evidence Base, Data collection and Better Regulation Instruments

Impact assessment

An impact assessment is under preparation for this initiative.

This proposal does not involve a formal evaluation of the BMR. The reason for this is that the BMR framework is not yet fully in place (entry into application on 1 January 2018, with final transitional periods expiring on 1 January 2022). However, early experience with the framework as well as external factors contribute to the conclusion that the topics set out above should be addressed with urgency.

Evidence base and data collection

- The Commission has been monitoring the implementation of the BMR with competent authorities via ESMA as well as with benchmark administrators and benchmark users in bilateral contacts.
- Furthermore the Commission is part of the Working Group on euro risk-free rates, an industry-led working group that is analysing the impact of the IBOR transition in the Euro area and recommending best practices.

Consultation of citizens and stakeholders

- The Commission has run a public consultation from 11 October until 31 December 2019; 85 respondents expressed their opinion, representing the following categories of stakeholders:
  - Benchmark administrators
  - Benchmark users
  - Benchmark contributors
  - National competent authorities
  - Consumers.
- On 26 November 2019, the Commission hosted a well-attended industry roundtable discussing the main topics of this initiative.

Will an Implementation plan be established?

An implementation plan will be established.