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February 1, 2021

LIBOR Update: European Parliament Adopts Amendments to Benchmarks Regulation

[33077]

February 1, 2021 TO: ICI Members
ICI Global Members
ICI Global Regulated Funds Committee
LIBOR Transition Working Group SUBJECTS: Compliance
Financial Stability
Operations RE: LIBOR Update: European Parliament Adopts Amendments to Benchmarks Regulation

The European Union Parliament recently voted to adopt targeted amendments to the Benchmarks Regulation (BMR)[1] in response to the expected cessation of most currencies of LIBOR on December 31, 2021.[2] The BMR amendments provide a pathway to addressing "tough legacy" contracts and financial instruments that will still reference LIBOR (or another discontinued benchmark rate) when that rate is discontinued.

This plenary adoption is expected to be published in the Official Journal of the European Union in the coming weeks. Highlights of the BMR amendments for regulated funds are discussed below.

Which contracts and financial instruments will be considered tough legacy?

In general, the BMR amendments address contracts and financial instruments that reference a ceased benchmark rate and contain:

- No fallback provision; or
- No suitable fallback provision;

The BMR defines "no suitable fallback provisions" as provisions that:

- Do not cover the permanent cessation of a benchmark rate. The preamble text states "[c]ontracting parties are responsible for analysing their contractual arrangement to determine which situations a contractual fallback provision intends to cover";[3]
- Require further consent from third parties that has been denied; or

- Do not reflect the underlying market or economic reality and could have an adverse impact on financial stability. This prong would require an interested party to request that a national relevant authority assess and make a finding that the fallback provision does not reflect market or economic reality and could have an impact on financial stability. The national relevant authority would inform ESMA and the European Commission of its assessment. Following the assessment, a party to the contract including such a provision must object to the fallback provision and be unable to agree on an alternative fallback provision with the other contractual parties before the benchmark rate permanently ceases.

The BMR will apply to any contract or financial instrument that is governed by the laws of a EU Member State and any contract that is subject to the law of a country outside the EU that does not itself provide for an orderly wind-down of a discontinued benchmark, if all parties to the contract are “established” in the EU.[4]

The BMR expressly would not consider as tough legacy any contracts or financial instruments “where all parties or the required majority” of parties have agreed to a different benchmark rate to replace a discontinued rate.[5]

What will the BMR do for tough legacy contracts and financial instruments?

The BMR will designate a new rate replacing all references to a benchmark rate in a tough legacy contract or financial instrument if:

- The competent authority for the benchmark rate has stated that the benchmark no longer reflects the underlying market or economic reality and cannot be restored;
- The administrator for the benchmark rate (or the competent authority overseeing that administrator) has stated that it will commence the orderly wind-down of the benchmark or will cease to publish that benchmark; or
- The competent authority suspends or withdraws its recognition for a benchmark administrator.[6]

The BMR amendments direct the European Commission to adopt an implementing act to provide the relevant date from which the replacement rates for a benchmark shall apply.[7]

How will the replacement rate for a ceased benchmark rate be determined?

The European Commission is directed to adopt an implementing act to designate the replacement rate for a benchmark rate, including any spread adjustment to be applied to the replacement rate and any conforming changes necessary for using the replacement rate.

In doing so, the European Commission must take into account recommendations from the central bank in the currency area for the discontinued benchmark or the alternative reference rate working group operating in that currency area. Before adopting the implementing act, the Commission will conduct a public consultation and solicit the recommendations of other relevant stakeholders, including any authority overseeing a benchmark administrator and ESMA.

Other issues

- **OTC Derivatives:** In order to facilitate support action by market participants to enhance the robustness of OTC derivative contracts, the BMR excepts contracts that are amended for the sole purpose of replacing the benchmark rate from clearing or margin requirements. This exception applies only to contracts amended to implement or prepare for the replacement for a benchmark due to a benchmark reform, but that make no changes to the economic substance of the OTC derivative or to contractual provisions unrelated to benchmark reform.[8]
- **Third-country benchmarks:** The BMR permits the use of benchmarks administrated outside the EU by EU-supervised entities within the EU only for financial instruments, financial contracts and measurements of the performance of an investment fund that already reference the third-country benchmark prior to December 3,1 2023.[9]

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endnotes

[1] The plenary vote adopting the amendments took place on January 19 with 592 in favor, 3 against, and 98 abstentions. *See also* the text of the amendments at Confirmation of the final compromise text with a view to agreement amending Regulation (EU) 2016/1011, Interinstitutional File: 2020/0154 (COD), *available at* https://data.consilium.europa.eu/doc/document/ST-13652-2020-ADD-1/en/pdf. In 2020, ICI reviewed the European Commission's targeted proposal to amend the BMR in ICI Memorandum No. 32639 (*available at* https://www.ici.org/libor/ici_resources/memos/memo32639) and submitted position papers to the European Commission and European Parliament. *See* ICI Memorandum No. 32777, *available at* https://www.ici.org/my_ici/memorandum/memo32777.

[2] *See* ICI Memorandum No. 32928, *available at* https://www.ici.org/libor/ici_resources/memos/memo32928. The cessation of most USD LIBOR tenors is expected on June 30, 2023. *See* ICI Memorandum 32950, *available at* https://www.ici.org/my_ici/memorandum/memo32950.

[3] *See* preamble paragraph (16).

[4] Article 2, Chapter 1a.

[5] Chapter 4a, Article 23a(9).

[6] Chapter 4a, Article 23a(2).

[7] Chapter 4a, Article 23a(8).

[8] Article 13a of Regulation (EU) No 648/2012.

[9] Article 51(5).