European Benchmark Regulation (BMR)

Presentation

CH & Co.

25 November 2015
Agreement on the regulation text

9 December 2015
Approval by the European Council

8 February 2016
Publication of ESMA's Opinion

15 February 2016
working document

27 May 2016
1st consultation paper

30 June 2016
Official Journal Publication

29 September 2016
Recommendations and Guidelines

10 November 2016
Technical guidance on the new regulations

30 March 2017
Draft Regulatory Technical Standard

1st January 2018
Entry into force of the regulation

1st January 2022
Compliance for the existing benchmarks

What is at stake with BMR regulation?

The European Benchmark Regulation covers indexes used as benchmarks in financial instruments traded in Europe. It was approved by the European Council on 9 December 2015.

The Regulation aims to address concerns that have arisen as a result of manipulation of benchmarks indexes such as the LIBOR, the EURIBOR and the TIBOR.

Benchmark indexes, what are we talking about ?

A Benchmark index is subject to BMR if it used to :

- determine the value of a fund;
- build a portfolio allocation;
- calculate a fund's (out)performance fees;
- determine the proceeds from a financial product or a financial contract;
- determine the value of a financial product.

What is in BMR scope ?

BMR guidelines are differentiated according to indices typologies, as defined below:

1. Critical benchmarks (IC): value of contracts underlying the benchmark is at least €500bn; alternatively when the benchmark has been recognized as critical in a Member State;
2. Significant benchmarks (SI): value of contracts underlying the benchmark is at least €50bn; alternatively when there are no or few market substitutes & when there would be an impact on financial stability if the benchmark ceased to be produced;
3. Non-significant benchmarks (INS): benchmark that isn't an IC or and SI
4. Commodity benchmark: When the underlying asset of the benchmark is a commodity as defined by MIFID II;
5. Regulated data benchmarks (IDR): Where the input data to the benchmark is provided directly from regulated venues;
6. Interest rate benchmarks (ITI): benchmark is determined on the basis of the rate at which banks may lend to, or borrow from, other banks or agents in the money markets.

➔ A benchmark necessarily belongs to one of the first three categories but could also belong simultaneously to one of the last three categories

Penalties For Non-Compliance With the BMR

- Authorities can impose financial and/or non-financial penalties for Financial Benchmarks Regulation infringement including cease and desist orders, €500,000 fine for individuals in breach of requirements, or €1 million or 10% of annual income for companies in breach of requirements.
- If a financial institution is using Benchmarks under BMR, it must:
  - Ensure the supplier of the benchmark is a registered administrator under BMR;
  - Ensure the benchmark is administrated by an official administrator based in the EU;
  - Ensure robust plans are in place to substitute a benchmark in the case of material change to or cancellation of a benchmark.

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LIBOR, Euribor and RFRs under BMR

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Benchmark regulation impacts on some major benchmark rates

Impact ✗ Heavy ⊖ Neutral ✓ Light

Criteria / Title	BMR impacts on critical benchmarks	Libor	Euribor	Sonia	Sofr	Ester (RFR)
Benchmark integrity and reliability	Governance of & control by administrators Annual independent external audit	✗	✗	✓	✓	✓
Requirements for different types of benchmarks	Mandatory administration of a critical benchmark (report assessment to ESMA) Measure the market or the underlying economic reality	✗	✗	✗	✗	✓
Transparency and consumer protection	Ensure fair and easy access to benchmark publication to all	⊖	⊖	✓	✓	✓
Use of benchmarks in the union	Ensure information relating to the benchmark are provided to all users on a fair, reasonable, transparent and non-discriminatory basis	⊖	⊖	✓	✓	✓
Authorization, registration and supervision of administrators	Competent authorities take into account the criticality of the benchmark to financial stability and the real economy	✗	✗	⊖	⊖	✓
Transitional and final provisions	By 1 January 2020, a report to the European Parliament shall be reviewed and submitted on the functioning and effectiveness of the critical benchmark	⊖	⊖	✗	✗	✓

Risk-free rates an alternative to the IBOR indexes

LIBOR limits and weaknesses:

After 2021, banks could stop submitting contributions to LIBOR. LIBOR is overly reliant on expert judgment rather than actual transactions. The underlying structure of financial markets has changed since the financial crisis;

The LIBOR presents a lack of underlying market liquidity for nearly all currencies and maturities because it is based on fewer unsecured interbank transactions;

LIBOR and EURIBOR are unregulated interest rates benchmarks and their calculation methodologies and governance could allow manipulation;

Risk-free rates main strengths:

BMR is applicable to Critical Benchmarks such as EONIA, EURIBOR and LIBOR. BMR significant number of binding rules & supervision mechanism is forcing these to change since they are not currently BMR compliant.

RFRs have been already chosen in the UK (SONIA), US (SOFR), Switzerland (SARON) and Japan (TONAR) and (ESTER) for short-term in euro area. All the RFRs are overnight rates and could be secured (SOFR) or unsecured (SONIA);

Compared to LIBOR which could rely on expert judgment, RFRs are more robust and could better handle future changes in money markets thanks to a high volume of observable transactions.

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