LMA Loan Market Association

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Dear Sirs

European Commission Public Consultation Document – Review of the EU Benchmark Regulation ("Consultation Paper")

The Loan Market Association ("**LMA**") welcomes this opportunity to comment on the proposed amendments to the EU Benchmark Regulation ("**BMR**").

The LMA is the trade body for the EMEA syndicated loan market and was founded in December 1996 by banks operating in that market. Its aim is to encourage liquidity in both the primary and secondary loan markets by promoting efficiency and transparency, as well as by developing standards of documentation and codes of market practice, which are widely used and adopted. Membership of the LMA currency stands at over 730 organisations across 67 jurisdictions and consists of banks, non-bank investors, law firms, rating agencies and service providers. The LMA is recognised across the market and has expanded its activities to include all aspects of the primary and secondary syndicated loan markets. Its overall mission is to act as the authoritative voice of the EMEA loan market vis à vis lenders, borrower, regulators and other interested parties.

The LMA has been following implementation of the BMR closely and is carrying out extensive work to ensure that its members are prepared for the cessation of an IBOR.

We have not provided responses to every question in the Consultation Paper, but rather have focussed on a small number of issues that are important to the LMA and its members and where we consider it is possible to make targeted amendments that would deliver significant improvements to achieving the aims of the BMR, including:

- The proposal for competent authorities to have strengthened powers regarding mandatory methodology changes to critical benchmarks;
- Clarification of the power to withdraw or suspend authorisation or registration of an administrator;
- The third country regime for non-EU administrators.

Our member institutions are likely to have other thoughts on the proposals and we have encouraged them to submit their own feedback on the Consultation Paper.

1. *Methodology changes in relation to 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? 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? Question 3: Are there any other changes to Article 23(6)(d) BMR relative to the change of methodology for critical benchmarks that might be desirable to improve the robustness, reliability or representativeness of the benchmark?

Whilst it could be useful for the power in Article 23(6)(d) BMR to be reinforced, it will be necessary to frame the scope of the power clearly and to set strong parameters around its use. In particular:

- we were concerned that the broad description of the power as described in the Consultation Paper could mean that competent authorities would have the power to specify what changes an administrator should make to their benchmark. We discuss this further below, but in summary while a competent authority can clearly identify concerns with a benchmark and ask the administrator to address these concerns, it would not be appropriate for the competent authority to direct the administrator to make specific changes to the benchmark.

- we were also concerned that a combination of the power to require an administrator to continue publishing a benchmark, and the power to require an administrator to make changes to its benchmark, could result in administrators being required to attempt a restructuring of their benchmark (and potentially incurring significant costs) in circumstances when it would be more appropriate simply to phase the benchmark out and for the market to identify an alternative.

As mentioned in the Consultation Paper, Article 23(6)(d) empowers competent authorities to require an administrator to change the methodology of a critical benchmark. We understand that this power was introduced into the BMR specifically in relation to critical benchmarks based on submissions by contributors the majority of which are supervised entities (and not in relation to other types of benchmark) in order to ensure that where supervised entities were being compelled to contribute input data, the benchmark could remain representative.

The Consultation Paper suggests that some administrators may be reluctant to make changes to the methodology or other rules of a benchmark (e.g., because they fear litigation resulting from the changes) and that it would be appropriate to strengthen regulators' powers to compel the necessary changes.

As an initial point, it is not clear that strengthening regulators' powers would reduce the litigation risk for administrators, particularly where a benchmark is widely used globally (as the majority of critical benchmarks are).

It is unclear exactly what is being proposed here beyond the existing power to require an administrator to change the methodology, code of conduct or other rules of a submission-based benchmark. If the proposal is for the competent authority to be able to specify changes which must be made to the benchmark, without the administrator having the ability to veto these changes, this would appear to result in the competent authority essentially acting as the administrator for the relevant benchmark (as the competent authority, rather than the administrator, would now have control over the benchmark). We consider that it would not be appropriate for the competent authority to have the power to compel specific changes but for the administrator to remain responsible for administering a benchmark which is no longer within its control.

If competent authorities were to have the power to mandate specific changes to a benchmark, it would be necessary for them to consider very carefully all of the potential market impacts of a change, and to consult widely on any proposed change well in advance of making it to ensure that the impact on all affected market participants has been properly assessed. In many cases, there will not be a clear specific change that can be made to a benchmark in order to address any concerns (and if there was, it seems most likely that the benchmark administrator would be best placed to determine what this change would be). It would also be necessary for the competent authority to ensure that any changes to the methodology would not result in a change to the underlying interest that the benchmark seeks to measure. This will be critically important for contractual continuity. For example, it has been possible to migrate EONIA to €STR plus a spread because the two benchmarks track a similar underlying interest[1]. However, for most other benchmarks there is no obvious equivalent replacement, and imposing a transition to another benchmark could therefore involve changes to the underlying interest and also be likely to require fundamental changes to documentation to adjust interest periods and payment dates to reflect the new benchmark.

If the proposal is to amend Article 21 to give competent authorities the power to require the administrator to make changes to any critical benchmark in circumstances where the competent authorities compel the administrator to continue publishing it, this would also appear to be disproportionate.

There are a wide range of reasons why administrators may be reluctant to make changes to the methodology or other rules of a benchmark. These may include the cost associated with the changes, or lack of obvious changes to the methodology or other rules in order to make the benchmark compliant with the BMR. In either of these cases the most straightforward route for an administrator may simply be to cease publication of the benchmark. It would clearly be disproportionate in either of these cases for the competent authority to mandate specific changes to the methodology and then compel the administrator to continue publishing the benchmark.

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[1] The migration of the EONIA methodology was also a result of recommendations being put to EMMI (as the administrator of EONIA) by the Working Group on Risk-Free Rates and then EMMI consulting on these recommendations before making the relevant changes, rather than the changes being imposed on EMMI.

Article 23 is limited to critical benchmarks based on submissions by contributors the majority of which are supervised entities. It is possible that changes to the methodologies for these benchmarks would be more obvious than changes to other types of benchmark, but a key point is that Article 23 does not contain a power for the competent authority to compel the administrator to continue publishing the benchmark. If the administrator considers that changing the methodology and other features of the benchmark would involve prohibitive cost or risk, or would materially alter the benchmark, they are entitled to cease publishing the benchmark. The same is not true for Article 21, so we do not consider that it would be appropriate to force an administrator to make specific changes to a benchmark and also to continue to publish that benchmark.

2. *Authorisation and registration*

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?

We agree that this is currently unclear and we welcome the Commission's proposal to clarify that a competent authority should have the option to suspend or withdraw authorisation or registration in respect of one or more benchmarks without having to suspend the authorisation for the administrator itself.

Authorisation and registration under Article 34 of the BMR are granted to a person that intends to act as an administrator. Once a person is authorised or registered, their name would be included on the public register maintained by ESMA under Article 36 (along with the identity of the competent authority responsible for supervising that person), and supervised entities will be entitled to use any benchmark published by that person.

Both Article 34 nor 36 indicate that authorisation or registration is granted at the level of the administrator, not at the level of individual benchmarks.

Similarly, Article 35 provides that a competent authority may withdraw or suspend the authorisation or registration of an administrator, and that ESMA shall promptly update its register upon being notified of this. The natural reading of this provisions would be that the competent authority may withdraw or suspend the administrator's authorisation in relation to all benchmarks that it publishes and, since ESMA's register only lists the administrator and not each individual benchmark, that ESMA would remove an administrator from the register upon being notified that its authorisation has been withdrawn or note that the administrator's authorisation has been suspended.

Since most administrators publish more than one benchmark, we agree that it would be useful to clarify that a competent authority may suspend or withdraw authorisation or registration in respect of an individual benchmark or benchmarks, and that they are not required to suspend or withdraw the entire authorisation or registration of an administrator.

This will also entail a clarification of Article 36, to ensure that ESMA's register lists all the benchmarks or families of benchmarks published by an authorised or registered administrator, otherwise supervised entities will not be able to establish whether or not they

are permitted to use a particular benchmark. Supervised entities should be able to rely on the register to establish whether or not they may use a particular benchmark.

We would also ask that the Commission consider amending Article 35 so that supervised entities may continue to use a benchmark where the administrator has had its authorisation suspended, as requiring supervised entities to cease using a benchmark only for the period of suspension is likely to lead to market disruption. If an administrator is unable to publish rates during the period of suspension, the parties would use any fallback provisions contained in their agreements, so effectively the benchmark would not be "used" during the period of the suspension. But prohibiting use of a benchmark without allowing for any transitional period or grandfathering for existing contracts is likely to lead to disruption.

3. *Recognition and Endorsement*

Question 24: What improvements in the [third country benchmark regime] do you recommend?

We are extremely concerned that the uncertainty and expense involved in both the recognition and endorsement regimes means that many non-EU administrators will not seek to use either route, with the result that a large number of third-country benchmarks that are currently used in the EU will no longer be able to be used after the end of the transitional period.

In particular, we are not aware of any other jurisdiction that has implemented benchmark rules that are as wide-ranging as those in the BMR. The jurisdictions that have implemented benchmark rules have typically focussed on a small number of specific benchmarks or on a particular category of benchmark (e.g., interest rate benchmarks). While this means that recognition may be available in relation to those limited number of benchmarks, it also means that a large number of less significant benchmarks will no longer be capable of being used by supervised entities in the EU.

For the syndicated lending market, the most obvious impact is on the ability of EU supervised entities to risk manage their exposures under loans. For example, while the BMR would not prevent EU supervised entities from entering into a syndicated loan referencing a non-EU benchmark, those EU supervised entities would not then be able to hedge their exposure under that loan by entering into OTC derivatives referencing that non-EU benchmark, as this would be restricted by the BMR. This means that either EU supervised entities would not be able to participate in relevant syndicated loans alongside other global banks (leading to a competitive disadvantage for EU supervised entities) or else they would need to try to hedge their risk through derivative products referencing benchmarks which approximate the benchmark used in the loan, resulting in less efficient risk management among other impacts.

In order to address the problems with the third country regimes, we would ask that the Commission reconsiders what risks the third country regimes are intended to address and adjusts the scope of the regime to align with these risks. There are a number of different approaches that could be used to calibrate the third country regimes appropriately, depending on the risks that the Commission considers need to be addressed. We have set out some potential approaches below:

- **Focus on consumer contracts**: if the key concern is to ensure that EU consumers enter into contracts which reference robust benchmarks that meet the standards set out in the BMR, the Commission could amend the scope of the prohibition under Article 29 BMR so that EU supervised entities are only prohibited from using non-EU benchmarks in financial contracts[2]. The risks associated with fund units or other financial instruments being sold to consumers are already significantly mitigated by the suitability and appropriateness obligations (among others) under MiFID2. If EU supervised entities take into account the reliability and robustness of any non-EU benchmark referenced in an instrument when determining whether or not it is suitable or appropriate for a retail client or consumer, it may not be necessary to further restrict use of non-EU benchmarks. This approach would achieve the aim of protecting EU consumers while also giving flexibility to EU supervised entities that operate in global markets and need to be able to reference global benchmarks.

- **Focus on critical benchmarks**: if the key concern is widespread use in the EU of major global benchmarks, ESMA could be tasked with identifying non-EU benchmarks which would qualify as critical benchmarks if published by an EU administrator. The Commission could then amend the scope of the prohibition in Article 29 BMR so that EU supervised entities are only prohibited from using critical non-EU benchmarks. These critical benchmarks are also the benchmarks most likely to be addressed by benchmark regulation in third countries, meaning that the equivalence regime is more likely to be helpful. This approach may also be more likely to incentivise non-EU jurisdictions to address these critical benchmarks in their own targeted benchmark reforms.

- **Tailoring the third country regimes**: another option (which could be used in combination with the approaches above) could be to tailor the third country regimes so that they are relevant to different types of benchmarks. For example, a more flexible and proportionate version of the recognition and endorsement regimes could be developed in relation to non-critical EU benchmarks.

We strongly recommend that the Commission should consult further on reforms to the third country regimes.

We would welcome the opportunity to discuss any aspect of our comments with you in more detail. If we can be of any further assistance, please do not hesitate to contact me via email at clare.dawson @lma.eu.com or by telephone on +44 (0) 207 006 2216.

Yours faithfully

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[2] "Financial contract" is defined in the BMR as any credit agreement as defined in Directive 2008/48/EC (i.e., consumer credit agreements) and any credit agreement as defined in Directive 2014/17/EU (i.e., consumer mortgage contracts).