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Briefing note May 2016

European Parliament adopts text of EU benchmarks regulation

The European Parliament has now adopted the text of the proposed Regulation on indices used as benchmarks in financial instruments and financial contracts. The new Regulation aims to curb conflicts of interest in setting benchmarks and will impose new requirements on firms that provide, contribute to or use a wide range of interest rate, currency, securities, commodity and other indices. This briefing reviews the next steps in the legislative process and the timing for implementation and comments on significant changes made by the text approved by the Parliament compared to the final compromise text published in December 2015.

Next steps and timing

The next step in the legislative process is that the Council of Ministers will be invited to endorse the Parliament's decision. After that, the institutions will complete the process of translation of the text into the official languages of the EU and the Regulation will be signed by the Presidents of the Parliament and the Council and then published in the Official Journal.

The new Regulation will come into force on the day after publication in the Official Journal, although its principal provisions will only apply from the date falling 18 months after the date on which it comes into force. Thus, if the new Regulation is published in the Official Journal in the summer, the principal provisions would apply from the end of 2017 or early 2018.

Given the recent approval by the Parliament, it is conceivable that the Regulation could be published before the end of June. The new Regulation amends the Market Abuse Regulation (MAR) with effect from 3 July 2016 (the date MAR begins to apply) and it would be desirable to ensure that these amendments are made prospectively and not with retroactive effect.

However, if the new Regulation were published in the Official Journal before the end of June, it would then apply from a date in 2017, i.e. before the expected date of application of the new Markets in Financial Instruments Directive and Regulation (MiFID2/MiFIR), which is now expected to be 3 January 2018. The new Benchmarks Regulation refers to terms in MiFID2/MiFIR, including references to the new category of organised trading facility (OTF) and the extended definition of a systematic internaliser, but unlike MAR (where similar issues arise), the new Regulation does not contain provisions addressing the position where it begins to apply before the date of application of MiFID2/MiFIR.

Therefore, the institutions might delay publication of the new Regulation to July 2016 so as to synchronise the date of application of the new Regulation with the proposed application date of MiFID2/MiFIR. If it takes effect at a later date that would mean that the amendments to MAR have retroactive effect.

Main changes to the text

At the end of last year, the Parliament and the Council reached provisional agreement on the new Regulation which resulted in the final compromise text published in December 2015. Since then the text has been the subject of further discussions between the Parliament and Council and review by the institutions' lawyer-linguists, resulting in the text approved by the Parliament in plenary session on first reading. Many of the changes are simple textual revisions, e.g., renumbering the recitals and articles, conforming cross-references and making the wording more consistent. However, there are other more substantial differences between the approved

text and the December text discussed below. References to articles are to the renumbered articles in the approved text.

Timing and transitional provisions

The new Regulation will require the European Securities and Markets Authority (ESMA) to draft regulatory and implementing technical standards (RTS/ITS) specifying the detail of many of the requirements. In response to concerns about the timing of the finalisation of the Level 2 process, the approved text sets a tighter deadline of nine months (instead of 12 months) after the date the Regulation enters into force for ESMA to deliver final drafts of the RTS and ITS to the European Commission. Even so, it is possible that the RTS/ITS - and the related delegated acts to be adopted by the Commission and ESMA guidelines - will only be finalised at a late stage before the new Regulation starts to apply, presenting practical challenges for market participants seeking to implement the obligations on time. However, ESMA has already begun the Level 2 process with its February 2016 Discussion Paper setting out its initial proposals for the RTS/ITS and its technical advice to the Commission on its delegated acts.

The new Regulation will empower the Commission to begin the process of identifying "critical benchmarks" immediately after the Regulation comes into force (Article 20). The approved text will also bring into immediate effect the provisions of the Regulation restricting the ability of administrators to cease providing a critical benchmark (Article 21) and empowering competent authorities to compel supervised entities (including those who are not already contributors) to contribute input data to critical benchmarks for up to two years (Article 23). This responds to concerns that the Regulation might cause contributors to cease to contribute input data to critical benchmarks in advance of the Regulation coming into application to avoid the new obligations that will apply to them under the Regulation.

The new Regulation will give EU index providers providing a benchmark on the date the Regulation enters into force a period of 42 months from that date (i.e. 24 months after the date of application of the Regulation) in which to apply for authorisation or registration under the Regulation (Article 51(1)). The approved text makes it clear that the provider of an existing benchmark may continue to provide that benchmark (and that supervised entities can continue to use the benchmark) until the date falling 42 months after the in force date or, where the index provider applies for authorisation or registration by that date, unless and until the application for authorisation or registration is refused (Article 51(3)). The approved text also clarifies that competent authorities have powers to allow investment funds (in addition to financial instruments and financial contracts) to continue to reference non-compliant benchmarks provided by EU administrators after the date falling 42 months after the entry into force of the new Regulation where this would otherwise be a force majeure event or would frustrate or breach the terms of the financial instrument, financial contract or rules of the investment fund (Article 51(4)).

The approved text will also provide a 'grandfathering' regime for the use of benchmarks provided by non-EU administrators at least where the benchmark is already used in the EU as a reference for financial instruments or financial contracts or for measuring the performance of investment funds at the entry into force of the Regulation. Even if the benchmark has not yet been qualified for use in the EU under the third country regime, the Regulation would now allow continued use of the benchmark in financial instruments, financial contracts or investment funds that already reference the benchmark at the date falling 42 months after the entry into force of the new Regulation (Article 51(5)).

However, the approved text does not make clear whether the transitional relief is restricted to existing benchmarks provided or used in the EU at the date of entry into force of the new Regulation or whether it applies to indices provided or used in the EU at the date of entry into application. The former approach would risk creating an 18 month hiatus after the in force date in which EU supervised entities may hesitate to start using new indices in financial instruments, financial contracts or investment funds. They would be concerned that they will have to suspend their use of the index when the new restrictions on use begin to apply, pending the administrator either obtaining authorisation or registration under the Regulation or qualifying the index for use in the EU under the third country regime.

The new Regulation will amend the consumer credit and consumer mortgage directives to require creditors or credit intermediaries to make certain disclosures to consumers where the contract references a benchmark. The approved text gives Member States 24 months (instead of six months) from the in force date to adopt the necessary national implementing rules and to bring those into force (Articles 57 and 58).

The approved text gives Member States until 18 months (instead of 12 months) after the in force date to

adopt their national rules on the penalties and other sanctions for contravention of the new Regulation (Article 42(3)).

Other changes

The new Regulation will impose less stringent requirements regarding input data on administrators of "regulated-data benchmarks". The approved text extends the definition of this term to cover benchmarks based on input data relating to financial instruments from third country trading venues where the European Commission has adopted a decision determining that the third country has an equivalent legal and supervisory framework to that in the EU within the meaning of Article 28(4) MiFIR or deemed equivalent under Article 2a EMIR (in addition to various EU venues) (Article 3(1)(24)(a)). This responds to concerns that the December text would have applied the full set of rules on input data to stock indices relating to non-EU markets. However, it will be important that the term "financial instruments" is given a broader meaning in this context than the defined term in the Regulation, since that term is limited to MiFID financial instruments traded on EU venues or via a systematic internaliser.

The approved text makes clear that a benchmark is only a "critical benchmark" if it appears on the list established by the Commission (Article 3(1)(25)).

The approved text requires an administrator's control framework to be made available to the competent authority and, upon request, to users (Article 6(5)). Administrators of non-significant benchmarks may choose not to apply this requirement (Article 26(1)).

The approved text explicitly allows administrators that are required to develop a code of conduct for the contributors to their benchmarks to develop a single code of conduct for each family of benchmarks they provide (Article 15(3)).

The December text required the administrator of a critical benchmark to take adequate steps to ensure that licences of and information relating to the benchmark are provided to all users pursuant to transparent rules based on objective criteria. The approved text now requires the administrator to take adequate steps to ensure that licences and information are available to all users on "a fair, reasonable, transparent and non-discriminatory basis" (Article 22). This is intended to align the obligations with similar obligations in Article 37 MiFIR, but goes further by imposing transparency requirements as well as requirements to treat users on a fair, reasonable and non-discriminatory basis.

The approved text makes some changes to the rules determining the "Member State of reference" for non-EU administrators seeking recognition of a benchmark under the third country regime (Article 32(4)). These are intended to make it clearer how a non-EU administrator identifies the Member State of reference to which it must apply to seek recognition. However, some non-EU administrators will still find it difficult to identify the Member State of reference where they lack the required information on the location of trading or use of their benchmarks.

For more information on the Benchmarks Regulation, see our previous briefing "The new EU benchmarks regulation: What you need to know" (February 2016) or our Topic Guide on Benchmark Reform and Regulation available on the Clifford Chance Financial Markets Toolkit.

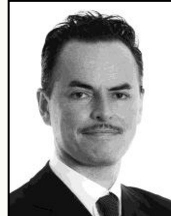
Contacts

Chris Bates
Partner, London

E: chris.bates@cliffordchance.com

Marc Benzler
Partner, Frankfurt

E: marc.benzler@cliffordchance.com



Lucio Bonavitacola
Partner, Milan

E: lucio.bonavitacola@cliffordchance.com

Caroline Dawson
Senior Associate, London

E: caroline.dawson@cliffordchance.com

Frank Graaf
Partner, Amsterdam

E: frank.graaf@cliffordchance.com

Sean Kerr
Senior Associate, London

E: sean.kerr@cliffordchance.com

Frederick Lacroix
Partner, Paris

E: frederick.lacroix@cliffordchance.com

Paul Lenihan
Lawyer, London

E: paul.lenihan@cliffordchance.com

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