Brexit & UK Benchmarks

As discussed in a paper published by the UK's Financial Markets Law Committee[1] (**FMLC**) on 23 October 2019, the main consequence of Brexit for the financial services industry is that the UK will be a 'third country' under EU law. While a deal on a transition period may postpone the issue and a subsequent 'soft' Brexit may mitigate its impact, once the UK exits the EU it will become a third country under EU law.

The UK becoming a third country for EU law purposes will impact how Irish Funds access UK administered benchmarks such as LIBOR's successor rate (if any) which will become third country benchmarks under the EU Benchmarks Regulation (**BMR**) post-Brexit. The extent of this impact on UCITS and Central Bank regulated AIFs (**Funds**) will, as outlined in the FMLC paper, be driven by, and depend on the sequence of, three key events:

1. The date on which the UK exits the EU

   Following the 'flextension' granted by the EU, the UK is scheduled to exit the EU on or before 31 January 2020.

2. The end of the transitional or grace period for third country benchmarks under the BMR

   Under the current transitional arrangements, third country benchmarks have until 1 January 2020 to become compliant with the BMR. After this date, Funds will be prevented from commencing to use third country benchmarks which do not comply with the BMR. However, there is an EU legislative proposal to extend the transitional period to allow providers of critical and third country benchmarks by a further 2 years (until 31 December 2021) to comply with the BMR. While this extension is expected to be finalised before the end of the current transitional period on 1 January next, the necessary EU legislation has yet to come into force.

3. The date (if any) on which LIBOR is replaced by a successor rate

   The continuation of LIBOR beyond the end of 2021 is not guaranteed and while significant efforts are being made to replace LIBOR, as yet no successor rate has been adopted on a market-wide basis.

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[1] The FMLC is an independent UK charity made up of public and private sectors and whose role is "to identify issues of legal uncertainty or misunderstanding, present and future, in the framework of the wholes ale financial markets which might give rise to material risks and to consider how such issues should be addressed."

What is the BMR and how does it impact a Funds use of UK benchmarks?

The BMR came into force in January 2018, subject to a 2-year transitional or grace period, and imposes requirements on administrators, regulated users of and contributors to, benchmarks. A Fund, as a regulated user, is required to use only those benchmarks which are included on the EU register for benchmarks maintained by ESMA. During the transitional period, EU benchmark administrators may apply to be included on ESMA's register and third country benchmarks may continue, subject to conditions, to be used by Funds.

At the end of the transitional period, the BMR will limit Funds to using:

1. benchmarks provided by an EU authorised administrator,
2. benchmarks that have been entered on ESMA's register for third country benchmarks, or
3. subject to conditions, third country benchmarks referenced in legacy contracts.

How will Brexit impact Funds use of UK benchmarks

Currently, UK benchmarks are eligible for use in the EU if the UK administrator is (or has applied to be, in accordance with the BMR transitional provisions) included on ESMA's benchmark register. Post-Brexit, UK administrators, (23 out of a total of 58 registered administrators) will be removed from ESMA's register as they will no longer qualify as EU administrators and once the BMR transitional period closes, access to UK benchmarks post-Brexit will only be possible via options (ii) or (iii) above.

For option (ii), a third country benchmark may be registered with ESMA based on a positive equivalence decision, recognition by an EU authority or endorsement by an EU benchmark administrator (**BMR third country regime**).

Option (iii) above facilitates the continued use by Funds of third country benchmarks which are in use in the EU on or before 1 January 2020 (or 31 December 2021, if the transitional period is extended). The BMR conditions for option (iii) state that, where benchmarks provided by third country administrators are "already used in the Union" for measuring the performance of a Fund, the BMR permits the use of such benchmarks after the end of transitional period but only by such Funds that use such benchmark on or before the end of the transitional period.

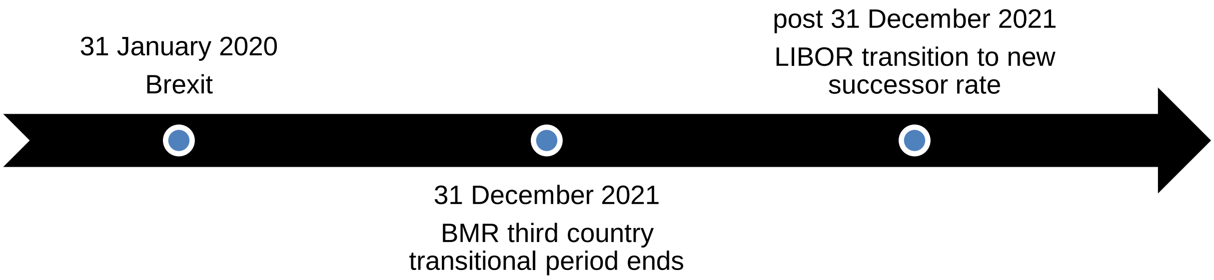
The Challenge for LIBOR's successor – a question of timing

If we assume, as has been indicated by the EU, that the legislation extending the BMR transitional period for third country benchmarks to 31 December 2021 takes effect by 1 January 2020, the following are the more likely scenarios as outlined by the FMLC.

Scenario 1

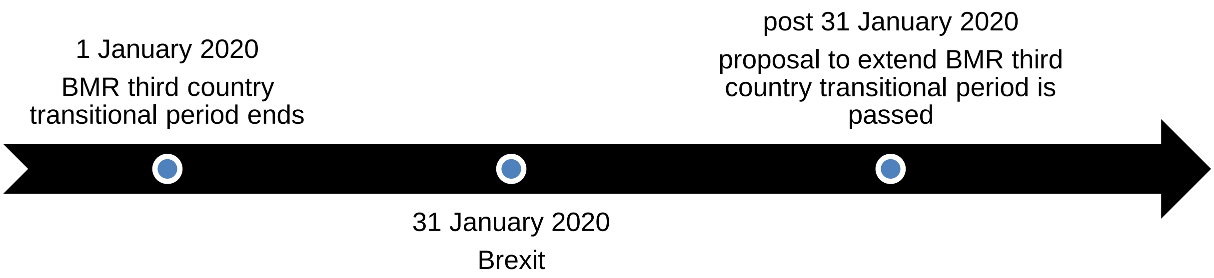
In this case, LIBOR's successor rate will be able to avail of the BMR transitional period, if it is established as "already used" in the EU and Funds which currently use LIBOR commence using the new rate before 31 December 2021. This would allow for the indefinite use of the successor rate by Funds already using the rate before 31 December 2021. However, given that LIBOR will be phased out "at the end of 2021", there may be a *"vanishingly small period of time during which [Funds] will have to begin [using] the new rate so as to be able to continue to do so after 31 December 2021".* Any new use of the successor rate would be subject to the requirement for the rate to be included on ESMA's register in compliance with the BMR third country regime.

Scenario 2

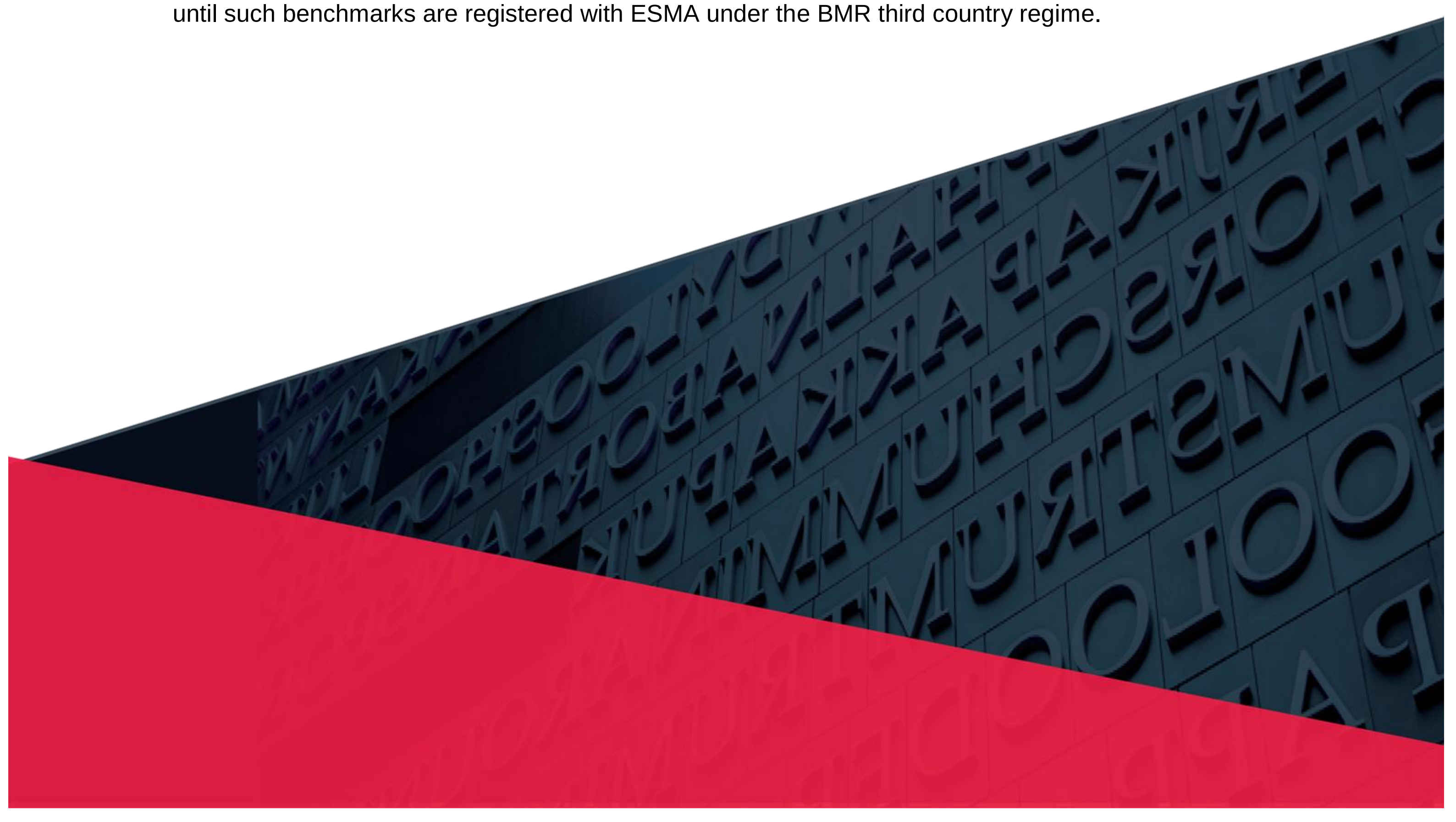


If, on the other hand, the transition from LIBOR takes place in 2022, after Brexit and the end of the transitional period, successor rates will not benefit from any transitional period under the BMR. Funds will be unable to reference a UK administered, unregistered benchmark in new or legacy contracts. The inability of Funds and other EU market participants to reference in the EU a benchmark administered by a commercial entity in the UK, especially one as critical as a replacement to LIBOR, would have a substantive impact on the market.

Scenario 3



If the BMR transitional period is not extended before the date of Brexit, UK benchmarks will not meet the test of being a third country benchmark in use in the EU on or before 1 January 2020. As of the date of the UK's exit from the EU, UK benchmarks would not be available for new or continued use in the EU until such benchmarks are registered with ESMA under the BMR third country regime.



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