FESE Position on the Benchmarks Regulation Review

Brussels, 4th June 2020

1. Introduction

The Benchmarks Regulation (BMR) was established following serious cases of manipulation of critical benchmarks based on contributed data. BMR was approved in 2016 and applies as of 2018. However, most EU benchmarks administrators were subject to a transitional period which ended in January 2020. Critical benchmarks and third country benchmarks administrator are still subject to a transitional period which ends in December 2021. This extended transitional period for the latter type of benchmarks was given by the co-legislator in the Climate Benchmarks file which amended BMR.

'Regulated data benchmarks' have a specific regime because these benchmarks are not prone to manipulation due to the use of regulated data which is based on transactions.

The Commission is required to perform a review of certain aspects of the functioning of BMR by 2020. In this context, the Commission held a stakeholder roundtable in October 2019 and published a public consultation in Q4 2019. The Commission has recently published an 'inception impact assessment'[1] where they indicate they would foresee further measures in Q3 2020. The Commission outlines that it would intend to solve three main 'problems': the first two are described as "urgent issues":

1. "Transition from panel-based critical interest rate benchmarks to risk-free rates published by central banks" and
2. "Ensuring a level playing field / international perspectives"

The third issue "Efficiency and proportionality of the regime" is meant to improve BMR e.g. regarding transparency authorisation and how administrator's authorisations are handled.

In the context of this review, FESE would like to highlight some key issues that Exchanges have encountered with the application of BMR. Some of the issues raised are based on the consultation that the Commission launched in Q4 where the Commission asked for stakeholders' views on a series of policy options.

2. Definition of regulated data benchmarks

BMR applies to all benchmarks, regardless of the underlying market. However, different types of benchmarks pose different types of risks to the markets. From a global perspective – where many developments have taken place - IOSCO has recognised that benchmarks based on regulated data should be subject to a proportionate approach. BMR acknowledged that regulated data benchmarks are less prone to manipulation. Nevertheless, experience with its application has shown that the framework does not differ much from that of other types of benchmarks.

The definition of regulated data benchmarks should be clarified regarding third country regulated data. Currently, only data from EU trading venues and a limited number of commodity exchanges fall within the definition. However, there are Exchanges in numerous third countries which are not included but should be covered.

[1] The document is available here.

The definition of regulated data benchmarks references equivalence decisions under Article 28(4) of MiFIR on the derivatives trading obligation and Article 2a of EMIR for OTC derivatives. However, it ignores equivalence decisions under Article 25(4) of MiFID II related to the share trading obligation. This may be a reference error. By not recognising such Exchanges as equivalent, a vast number of equity benchmarks cannot be classified as regulated data benchmarks. This may deprive EU investors from access to innovative indices and access to emerging markets. In addition, non-EU regulated data benchmarks may be deprived of the intended exemption from being deemed a 'critical' benchmark.

3. Non-significant benchmarks

BMR categorises benchmarks as critical, significant or non-significant, based on the value of instruments, contracts and or funds referencing it. FESE considers that the regulatory framework applying to non-significant benchmarks is not proportional. We believe that much of the governance and control requirements would not have to be applied to non-significant benchmarks, especially in cases where there are very little assets under management. The calibrations as such are appropriate, but the overall compliance requirements are disproportionate.

4. Climate-related benchmarks

In 2019, in the context of the sustainable finance agenda, a regulation on climate benchmarks, defining two new types of benchmarks was adopted. These types of benchmarks need to comply with a set of dedicated requirements to benefit from the label of 'Paris-Aligned' or 'Climate-Transition' benchmark. This is a welcome development as, while there were already a spectrum of low carbon benchmarks available to the market, consistently applied and clear definitions could help bring consistency and clarity.

FESE does not consider that a specific approach to supervision should be adopted for climate benchmarks. If investment managers and benchmark administrators would be required to go through a special verification process each time a new climate related product is requested by a client or launched by an investment manager this may discourage the development of products based on climate related benchmarks. However, there should not be any suggestion of customers being misled by information regarding a climate related benchmark or investment strategy referencing such a benchmark, or not being advised in accordance with the applicable rules and regulations. In such cases, authorities have the powers to act. Using a climate related benchmark that does not meet the climate related benchmark rules and claiming that the investment strategy is aligned with EU rules on climate related benchmarks, should be an offence.

5. Commodity benchmarks

FESE does not consider that that current conditions for commodity benchmark are appropriate. There is a lack of clarity between provisions for regulated data benchmarks and commodity benchmarks and how these overlap for benchmarks that fit into both frameworks. FESE would, therefore, see benefits in clarifying the applicable provisions. There should also be a proportionate approach to regulate commodity benchmarks that fall under Annex II, taking into account the size of the benchmarks and the data sources. The calibration of thresholds for commodity benchmarks should also be re-considered.

6. Third country regime

We appreciate the different methods for how third country benchmark providers could bring their benchmarks into the EU. However, reality shows that equivalence is not always an option and the recognition process sets up large hurdles, due to the need for an establishment of a legal presence in the EU. The endorsement process would benefit if the requirements could be described and defined in more details in BMR or via an RTS.

The third country regime presents some challenges as, while EU supervised entities can only use benchmarks that are authorised for use in the EU, some third-country

benchmarks that are important for currency or interest rate hedging are not authorised for use in the EU. FESE would support sensible legislation allowing the use of FX spot rates for not fully convertible currencies as reference rates for non-deliverable forward contracts.

7. Critical benchmarks

FESE does not consider that competent authorities should have broader powers regarding methodology modifications for critical benchmarks. On the contrary, we consider that this could create uncertainty for users regarding the continued provision of such benchmarks.

FESE supports that critical benchmarks' cessation plans should be approved by national competent regulators. NCAs should ensure that the cessation of a critical benchmark is conducted in an orderly fashion, without causing market disruptions and legal uncertainties.

8. Definitions and data clarification

FESE members have encountered some issues in relation to the application of the BMR definitions. These are outlined below.

3.1 Definition of "index"

There is a lack of clarity regarding the definition which we think has led to indices originally not intended to be in scope becoming regulated. 'Made available to the public' could benefit from more guidance. Alternatively, the definition could be narrowed down, e.g. to refer to indices that are in widespread use within financial instruments/ contracts.

3.2 Definition of "financial instrument"

The definition is drafted very widely. This has caused significant challenges in identifying with certainty what instruments are within scope of the BMR. In particular, the SI component of the financial instrument definition seems unintentionally to have brought within scope certain OTC derivatives. This does not seem consistent with recital 9 of BMR. Determination of in-scope SI use is further hampered by the lack of a comprehensive SI register data (in particular in relation to commodity-related instruments). On this basis, it would be appropriate to remove the reference to "via an SI" from the scope of the BMR "financial instrument" definition.

3.3 Availability of data on exposure towards benchmarks

It would be useful to receive clarification regarding whether BMR is intended to apply to supervised entities when transacting with non-EU counterparties or being used by an investment fund that is distributed solely outside the EU. Financial products and the associated trading venues or systematic internalisers are listed in FIRDS and are in scope of the BMR. It would be beneficial if those trading venues and systematic internalisers could be incentivised to be transparent about exposure towards benchmarks and make the information about the volume, notional and open interest available to the benchmark provider. An example are traded derivatives contracts on reference rates (swaps). These are of high interest due to the LIBOR transition.

9. Transparency of methodology and benchmark statements

9.1 Transparency of methodology

BMR includes detailed requirements regarding transparency of methodology and these requirements have been further strengthened by the Climate Benchmarks Regulation. However, some stakeholders are calling for further disclosure requirements. In this context it is important to consider that disclosures need to be well-suited to the respective target groups, whether it is information to be made public or to be provided to customers of benchmark providers. While benchmark providers are already very transparent and publicly disclose their methodologies - including information on the respective third-party data sources - certain proprietary data are usually disclosed only to customers with whom

administrators have contractual arrangements. However, data owned by third parties, such as data vendors and research providers, may usually not be disclosed at all.

9.2 Benchmarks statements

Benchmarks statements are currently not very useful. A template would help administrators better understand exactly which information is required and allow users to better compare different statements. Moreover, there are currently overlapping requirements between information that should be included in the benchmarks statement and the provisions related to transparency of methodology. Clarification would be helpful to streamline procedures and simplify compliance with a view to assessing the need of the benchmark statement altogether as most information is already available via other means.

The option to publish the benchmark statement at benchmark level and at family level should be maintained. While we do not believe there is much added value in a separate benchmark statement, users often demand this information and, therefore, should the benchmark statement be maintained, we would support combining statements in a "family of benchmarks statements".

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