

ISDA response to ESMA's Consultation Paper on Draft regulatory technical standards under the Benchmarks Regulation

The International Swaps and Derivatives Association (**ISDA**) welcomes the opportunity to respond to ESMA's consultation paper on draft technical standards under the Benchmarks Regulation. It is based on responses provided by members of the ISDA EU Benchmarks Regulation Advocacy Group, ISDA Americas and Europe Benchmark Working Group; ISDA APAC Benchmark Working Group; ISDA Article 28(2) EU Benchmark Regulation Group; ISDA JPY Benchmark Working Group. Not all members responded and not all members of ISDA are members of these working groups. Not all members who provided feedback responded to all of the questions. The views may not, therefore, reflect the full range of views held by ISDA's membership or of the working group in their entirety.

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Executive summary

We have set out our detailed comments below in response to ESMA's questions. However, by way of a high level summary we have the following key comments in relation to the proposals:

- We are concerned that some of these requirements impose disproportionate costs and operational burdens on benchmark administrators, particularly when compared with the fairly limited incremental benefits that these requirements may bring. We have flagged requirements that are of particular concern below, and propose either that there should be an opt-out for non-significant benchmark administrators or that administrators should have the discretion to apply these requirements as appropriate and proportionate in the context of their benchmarks.

- **Governance RTS:** We have flagged some additional points where clarity would be welcome, such as the accountability requirements.
- **Methodology RTS:** The draft RTS (and particularly the back-testing requirements) would pose significant operational challenges to non-significant benchmark administrators. We are concerned that these requirements go beyond international standards and would further undermine the competitiveness of the EU regime. We have proposed some amendments to mitigate this risk.
- **Surveillance RTS:** We welcome the clear confirmation in the draft RTS that these requirements apply "to a degree which is appropriate and proportionate in relation to the nature, scale and complexity of the benchmark", as this clearly gives flexibility to administrators of very simple, straightforward benchmarks to introduce monitoring that is proportionate. We strongly agree with ESMA's proposal that an automated system should be required only when it appears to be adequate according to the nature, scale and complexity of the benchmark.
- **RTS on transition and cessation of administration of critical benchmarks:** As a general point we agree with the criteria proposed for national competent authorities to take into account. We also consider that it will be important for the national competent authority to consult users of the relevant benchmark and other market participants as part of its assessment of these criteria.

Q1: Do you agree with the governance arrangements set above? Do you have any additional suggestions? Please specify.

Recital (5) of the Governance RTS seems to exclude the applicability of Article 1.5 to non-significant Benchmark administrators. Nonetheless, Article 1 is silent on such exclusion. It should be clarified that administrators of non-significant benchmarks may opt-out from complying with Article 1.5 of the Governance RTS. The draft RTS on governance arrangements are generally sensible and appropriate. However, we would welcome clarity regarding the accountability requirements under the Governance RTS, especially around the granularity that is required to determine the accountable person.

If you refer to Articles 1(1) and 2(1)(a) of the RTS, it is not clear what type of decision an accountable person is required for. Such a requirement could be very onerous and may also be redundant where there is already a governance framework in place. For example, Articles 6 and 7 of the BMR already provide for the creation of an accountability and control framework and the existing record-keeping requirements already provides for strong recording of all steps necessary to the provision of a benchmark.

We would also like to flag Article 1(2), where the current wording regarding the "management body" may not be equally applicable to banks and other larger organisations. Even if the benchmark administrator is part of a larger organisation, the management board is not necessarily involved in the decision-making process. Article 1(2) should therefore be

modified by restricting its application to the managing or governance body of the benchmark administrator.

Additionally, we would like to highlight that the second sentence of Article 2(2) requires the establishment of “written outsourcing arrangement in accordance with Article 10 of Regulation (EU) No 1011/2016” in order to share staff among group entities. We believe this provision doesn’t follow the proportionality approach set out in Article 10 of the BMR, which only applies to outsourcing arrangements which may “impair materially the administrator’s control over the provision of the benchmark or the ability of the relevant competent authority to supervise the benchmark”. Such proportionate approach is also present in other regulatory provisions addressing outsourcing arrangement, such as Article 16(5) of MiFID. Consequently, we propose to remove the second sentence of Article 2(2) given its disproportionate scope.

Finally, Article 3.2 of the Governance RTS seems to overlap completely with the provision set out in Article 1.2 of the same RTS. Hence, we propose to remove article 3.2 as it seems duplicative.

Q4: Do you think that other conditions should be taken into account to ensure that the methodology complies with the requirements of the BMR? Please specify.

We do not consider that other conditions need to be taken into account to ensure that the methodology complies with the requirements of the Benchmarks Regulation.

Since the introduction of BMR, EU Benchmark Administrators have significantly improved the transparency and oversight of the methodologies used for calculating benchmarks. While the additional requirements under the draft ESMA RTS on Methodology are important for ensuring that critical benchmarks reflect the underlying market and economic reality, we urge ESMA to take into account the proportionality of the rules for other benchmark administrators.

No other jurisdiction has implemented a regime for benchmark administration as stringent as the EU BMR. As currently proposed, ESMA’s draft RTS would pose significant operational challenges to non-significant benchmark administrators. These requirements go beyond international standards, and would further undermine the competitiveness of the EU regime.

In order to address this, we would welcome the inclusion in the methodology RTS of an opt-out for administrators of non-significant benchmarks in relation to all of the obligations under the RTS (not just in relation to back-testing and methodology resilience), so that the detailed requirements set out in the RTS would only apply to those administrators if they decided that they are appropriate and proportionate given the nature of the relevant benchmark.

Benchmark administrators who have opted out from these requirements would still be subject to the less detailed basic requirements set out in Article 12 of BMR.

We would also welcome clarification from ESMA as to whether administrators will be required to disclose information regarding the additional detailed requirements set out in the

methodology RTS. If so, we consider that it would be appropriate for any disclosure requirements to be limited in relation to non-significant benchmarks as this is likely to introduce market sensitivities and involve disproportionate operational burdens.

In addition, we would welcome confirmation that administrators are only required to meet these conditions in relation to new benchmarks which they start to publish on or after the application date of the RTS. If administrators are required to meet all of these conditions in relation to all existing benchmarks then this will require significant work to implement. If it is not possible to give this confirmation, we would welcome the insertion of transitional provisions or a phased approach to implementation.

We also had the following more detailed comments on the draft RTS:

- Article 2 on clear rules identifying how and when discretion may be exercised in the determination of that benchmark: we consider that the requirements as proposed offer significant operational challenges. The requirements include many elements (e.g. at which step of the calculation of the benchmark discretion is performed; the methodology used for determination of expert judgment; the input data to be taken into account when discretion is used), and we do not consider that these should have to be included in each existing rulebook.
- In addition, we do not see any material difference between Expert Judgement and discretion, since the definition of Expert Judgement is the use of discretion (Article 3(13) of BMR). We consider that there is a risk of divergence in using the two terms with one defined and the other not, so we would urge ESMA to use existing defined terms where possible and avoid introducing additional overlapping and undefined terms, particularly when relevant to such a central definition to the supervision of benchmarks.
- Article 3 on back-testing: given the minimal risks of non-significant benchmarks to market integrity, we consider that the operational challenges of implementing the requirements on back-testing against available transaction data outweigh the limited benefits they would bring. We discuss this further in our response to Question 6.
- Article 4 on methodology resilience and calculation in the widest set of possible circumstances: in practice, it is not possible to specify every scenario in which the transaction data in the underlying market would be considered insufficient, and therefore discretion could be exercised. For example, recent and unprecedented events such as negative oil prices indicate the difficulty of forecasting stressed market events using historical data. As such, we would suggest an “alternative” bucket for all other conditions that may cause disruption.
- We would also recommend deleting the references in Articles 4(1) and 4(2) to "hypothetical data" and "hypothetical conditions". While it is practicable for benchmark administrators to assess the impact of historical conditions, it is unclear what hypothetical data and hypothetical conditions an administrator would be

expected to consider. As with other requirements that we have flagged in this response, this seems likely to impose significant additional burdens on administrators with limited benefit for the integrity of the benchmark.

Q5: Do you consider that additional requirements are needed to ensure that the methodology is traceable and verifiable? Please specify.

We do not consider that any additional requirements are needed to ensure that the methodology is traceable and verifiable.

However, as mentioned above in our response to Question 4, we would welcome confirmation that administrators are only required to meet these conditions in relation to new benchmarks which they start to publish on or after the application date of the RTS.

Q6: Do you think that the back-testing requirements are appropriate? Please specify.

We are concerned that the back-testing requirements appear to go beyond the scope of the Level 1 text, which only requires back-testing against available transaction data "where appropriate". Article 3 of the draft RTS appears to indicate that all administrators should conduct back-testing, and that the minimum requirements would be those set out in Article 3(2). This is reinforced by Article 3(3), which provides that administrators of non-significant benchmarks may opt out of the provisions in Article 3(2)(c) and (d) – this should not be necessary if those administrators have determined that back-testing against available transaction data is not appropriate for their benchmark.

As a result, we would recommend that Article 3 should clarify that these requirements apply only if the administrator has determined that back-testing against available transaction data is appropriate for their benchmark, in line with the Level 1 text. Specifically, administrators of non-significant benchmarks should be able to opt out from compliance with all provisions of Article 3(2) based on the proportionality principle set out in the Level 1 text.

In particular, we are concerned by the proposal that the back-testing frequency be identical to the frequency of the calculation of the benchmark. For benchmarks which are calculated daily, this would require a benchmark administrator to have a process simultaneously for calculating the benchmark and for back-testing it. For many benchmarks there may not be adequate transaction data available on a daily basis for the administrator to conduct appropriate back-testing yielding meaningful statistical results. It would seem to be more appropriate for the administrator to set an observation period for the benchmark and back-test its performance over that period, giving the administrator an overview of the benchmark's performance over (e.g.) a three month period. At the very least it should be possible for administrators of non-significant benchmarks to opt out of this requirement (in the same way that they can opt out of the requirements in paragraphs 2(c) and (d)).

Benchmark administrators currently perform back-testing at inception of a new benchmark or when implementing material methodology changes. It is unclear what daily back-testing would add in the context of a benchmark that has been calculated for many years.

For administrators of significant benchmarks, we would suggest amending Article 3(2)(b) to refer to "an appropriate" historical time horizon instead of the "most appropriate" time horizon, as there are often several possible time periods that would be equally suitable. We would also suggest deleting Article 3(2)(d) completely. The current wording requiring "documentation of the actions" following the back-test and a "process to identify and address systemic anomalies" could lead to a disproportionate and unnecessary burden on administrators, without adding a real benefit to the quality of the benchmarks.

We would also make the following comments:

- From the perspective of the client, the requirements around back-testing, scenario analysis and methodology resilience would not necessarily enhance transparency beyond what is already provided by non-significant benchmark administrators. They would also make benchmarks more expensive to administer, and therefore reduce choices for investors.
- The IOSCO Principles do not include back-testing as a requirement for benchmark administration, and so far as we are aware there is no such obligation on administrators of benchmarks in other jurisdictions (and in any event, all the other jurisdictions that have introduced benchmark regulation only impose obligations on the administrators of specified benchmarks, rather than on all administrators in their jurisdiction, so the impact of any such obligation would be significantly reduced).

Q7: Do you agree with the requirements set out above? Do you have any additional suggestions? Please specify.

ISDA regards the detection and prevention of attempts to manipulate benchmarks as crucial to maintaining confidence in the financial markets and in this respect supports a strong regulatory environment. We welcome the clear confirmation in the draft RTS that these requirements apply "to a degree which is appropriate and proportionate in relation to the nature, scale and complexity of the benchmark", as this clearly gives flexibility to administrators of very simple, straightforward benchmarks to introduce monitoring that is proportionate.

However, we do have the following comments:

- We would propose deleting the "Benchmark Manipulation Assessment" set out in Article 3, as the requirements addressed in this appear to duplicate the requirements in Article 2(1). Alternatively, the requirements should allow the assessment to be carried out at the benchmark-family level or for several benchmark families sharing similar characteristics and input data at the same time.

- Again, Articles 4(1) – (3) seem to be covered by Article 2(1). These articles could either be removed or be amended to highlight that the design and implementation of the “adequate systems” should be decided by the administrator. Specifically, administrators of non-significant benchmarks should be able to opt out from complying with these provisions in line with the proportionate approach set out in article 2(1) as well as the existing opt-out provisions laid down in Article 26 of BMR in respect of Article 14.2 of BMR.
- While we welcome confirmation that benchmark administrators can use third party service providers to carry out data analysis on their benchmarks, we do not consider that this should be subject to formal requirements in relation to outsourcing. In particular, the requirement in Article 4(4)(a) for the administrator to "retain the expertise and resources necessary for evaluating the quality of the services provided" is a requirement more appropriate to the outsourcing of regulated activities, where the entity doing the outsourcing should have the relevant expertise and resources in the first place. Administrators should clearly remain responsible for identifying manipulation or attempted manipulation of their benchmark, but they should be able to delegate the analysis that contributes to identifying manipulation without being required to duplicate the relevant expertise.
- We do not consider that the notification referred to in Article 5(1) should have to describe the likely consequences of the manipulation – this is likely to delay notifications while the staff involved in the protection of data integrity attempt to analyse the potential consequences. It should be sufficient for the staff to notify potential manipulation to the person in charge of the oversight function (who is more likely to be qualified to assess the likely consequences of the manipulation in any event).
- We would also like to make a general observation relating to the scope of the RTS and definition of regulated-data benchmarks. While this is not the purpose of this consultation, it should be highlighted that the current definition in Article 3(1)(24) should be amended by defining “regulated data” instead of “regulated-data benchmarks”. This would expand the scope of application to all regulated data regardless of whether they are used in conjunction with non-regulated data in specific benchmarks.
- Administrators of non-significant benchmarks should be able to opt out from complying with Article 7 given the disproportionate compliance costs of these measures in line with the existing proportionate approach set out in article 2(1) as well as the existing opt-out provisions laid down in Article 26 of BMR in respect of Article 14.2 of BMR.

Q8: Do you agree with the systems suggested for the surveillance of market manipulation? In particular, do you think that an automated system should be required only when it appears to be adequate according to the nature, scale and complexity of the benchmark? Please specify.

ISDA regards the detection and prevention of attempts to manipulate benchmarks as crucial to maintaining confidence in the financial markets and in this respect supports a strong regulatory environment. We strongly agree with ESMA's proposal that an automated system should be required only when it appears to be adequate according to the nature, scale and complexity of the benchmark. Many benchmarks that will fall within the scope of these requirements have simple methodologies with limited inputs, and requiring them to purchase and establish automated systems for surveillance of production of their benchmarks would be completely disproportionate to the nature and complexity of the benchmark.

Q9: Do you think that other criteria should be considered in relation to the transition of the provision of the critical benchmark to a new administrator? Please specify.

We agree that, where a benchmark is to be transitioned to a new administrator, it will be necessary to ensure continuity of that benchmark, including ensuring that there is co-operation between competent authorities where provision of a benchmark transitions to a new administrator in a different Member State.

While we do not consider that other criteria should be considered in relation to the assessment of how a benchmark is to be transitioned, we would note that these criteria should not prevent an administrator from transferring administration of a benchmark in any way permitted under the BMR. For example, if an administrator intends to cease providing a benchmark, it may consider transitioning administration of the benchmark to a third country benchmark administrator. So long as that third country benchmark administrator is able to comply with the requirements for such administrators under the BMR, the assessment under Article 21 should not prevent this transition.

In view of the forthcoming revision of the BMR, we also note that these criteria should take due account of any additional supervisory powers to be provided to the competent authorities, including the power to mandate the continued provision of a critical benchmark using a different methodology or the provision of a replacement rate.

The national competent authority should also consult users of the relevant benchmark as well as other market participants as part of its assessment of the criteria, including in relation to its assessment of legal risks involved in the transition.

Q10: Do you think that other criteria should be considered in relation to the cessation of the provision of a critical benchmark? Please specify.

In addition to the criteria listed, national competent authorities should also consider the reason for the proposed cessation of the benchmark and any risks associated with compelling the administrator to continue to publish the benchmark.

While this is not an additional criterion, it will also be important for the national competent authority to consult users of the relevant benchmark and other market participants as part of

its assessment of these criteria, including as part of its analysis of the term, duration, maturity or expiry date of any financial instruments which refer to the critical benchmark, whether the cessation of the benchmark would have an adverse impact on market integrity etc, whether the cessation of the benchmark would result in a force majeure event and whether there are legal risks involved in the transition.

In particular, it is unclear how any national competent authority would establish the risk of a force majeure event, frustration or breach occurring in relation to users of the benchmark, who may not be within their jurisdiction (and when the majority of contracts referencing a particular benchmark would not be publicly available).

Q12: Do you agree with the criteria under which competent authorities may require changes to the control framework requirements? Please specify.

The draft RTS on Article 26 and the additional powers for NCAs generally seem sensible and should facilitate a proportionate exercise of their mandate.

In particular, we consider it to be important that the draft RTS should only require changes to the compliance statement (as they currently do, as drafted) and not to the control statement. While a change to the compliance statement may very well necessitate a change to the control framework there is a significant difference. Despite the RTS only directing change to the compliance statement, we agree with this change since the control framework should be left to the administrator. The control framework is typically a core governance mechanism to ensure compliance with the EU BMR and it should be left to the administrator to design it as a whole insofar as it is sufficient under the EU BMR and is congruent to the compliance statement.