ISDA. Safe, Efficient Markets

24 January 2014

ISDA comments on the European Commission proposal on Benchmarks

1 - Introduction

On behalf of our members, ISDA[1] is strongly supportive of a robust and effective financial market in the European Union and globally. We are convinced that the integrity of the financial markets must be resolutely defended for the good of all stakeholders, and that investors must be assured of fairness in the marketplace. With this in mind, we generally support the legislative proposal for benchmarks, as it improves governance and controls over the benchmarks process. We would like to state specific support for certain aspects of the proposal:

- Developing the proposal in line with international work (e.g., IOSCO Principles for Financial Benchmarks);
- Restricting the scope to indices made available to the public and used as benchmarks in products (Article 3.2);
- Calibrating requirements based on size and nature of benchmark (e.g., Articles 10 and 13 and Annexes II and III);
- Recognising that discretion and judgment are elements in the benchmark process (Art. 5 and 7);
- Attempting to provide legal certainty as to the continuity of EU outstanding contracts (Art. 39).

However, we would also like to highlight in this paper some issues regarding the proposal, that have been identified as concerns for our members (Section 3 below). These are primarily aimed at ensuring that the regulation applies in a proportionate way, based on the significance and nature of benchmarks, and that legal uncertainty is avoided regarding positions and investments in covered financial products.

The most important of these are the following:

- **The scope should be proportionate**, by considering the diversity of benchmarks in order to establish an effective benchmark regime (**See 3.1 click here**).
    - **Solution**: (1) Introduce greater calibration of requirements, and allow competent authorities to apply to ESMA for waivers, based on the significance and nature of a benchmark; and (2) Exempt certain benchmarks due to their special characteristics (as identified by ESMA standards).

[1] Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 64 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

- **Mandatory contribution as set out in Art. 14 could provoke a set of harmful effects** (e.g., unfit contributors, low-quality data) (**See 3.3 click here**)

  Solution: Contributors should be able to challenge the mandatory contribution.

- **Deleting the mention of *"there is* a *physical separation of employees in front office function and reporting lines"*** in Annex I-Section I.8a, since it applies the same set of rules to a great diversity of benchmarks (**See 3.4 click here**).

  Solution: Deletion of section 8b in Annex I - Section I.

- **An overarching concern about the equivalence procedure established in Art. 20**. In many third-country jurisdictions there is no regulatory framework on benchmarks (as stated by IOSCO[2]) or one with such a wide scope of application, such a procedure would seriously undermine EU competiveness (**See 3.10 click here**).

  Solutions: A regime which is based on compliance of IOSCO Principles by the non-EU administrator

- **It is crucial that the transitional framework (Art. 39) is improved to avoid market uncertainty**. Additionally, more granular detail is strongly recommended, to provide legal certainty as to continuity of outstanding contracts referencing existing benchmarks (**See 3.12 click here**).

  Solution: The transitional framework should be further calibrated. In particular, it should be applied to non-EU administrators; have transitional / grandfathering provisions for new benchmarks in the future; and timing should be aligned to bring clarity for users on benchmark equivalence and authorisation.

2 – List of issues in this paper

As stated above, **scope** (Art.2), **critical benchmark** (Art. 3.1.21, Art. 13 and Art. 14), **governance requirements** (Art. 5 and Annex I A-Section 1.8), **equivalence of third-country administrators** (Art. 20) and **transitional framework** (Art. 39) are the most important issues from an ISDA members' perspective.

The other issues that we would like to highlight are the following:

- **Definitions** (Art. 3): further guidance should be given regarding some definitions (i.e., 'benchmark', 'trading venue').
- **Administrators - Input data and methodology** – (Art. 7): To address some limitations posed by Art. 7.1, investment fund NAV should be considered as Regulated Data (Art. 3.1.1).
- **Reporting breaches** (Art. 8): Systems and controls to ensure the integrity of the input data, should consider the variety of benchmarks.
- **Code of conduct** (Art. 9): Further clarifications should be given on whether the code of conduct requirement is applicable to benchmarks produced by using internal data.
- **Regulated data** (Art. 10): Additional clarity on why the administrator and the contributor must enter into an agreement would be welcome.

[2] IOSCO - The IOSCO Principles published in July 2013 - p. 8.

- **Transparency** (Art. 15, 16 and 17): Intellectual property rights and confidentiality agreements should be preserved when disclosing index methodology.
- **Requirement for Authorisation** (Art. 22): For legal certainty purposes, the term 'intended to be used' should be either defined or deleted.
- **Application for authorisation** (Art 23): We would welcome longer timeframes in order to comply with these administrative requirements.
- **Interest Rates and Commodities benchmarks** (Annex II and III): Technical details in commodities and interest rates should be provided in Level 2 rather than in Level I (Annexes)

3 - Key issues (detailed account)

3.1 - Scope (Art. 1)

In order to strike a balance between integrity and proportionality, we suggest a two-step calibrated approach regarding the scope. Firstly the definition of benchmark would be refined by ESMA, based on standards identifying certain features of benchmarks which justify the application of the Regulation. Competent authorities should be able to apply for waivers of specific requirements for specific benchmarks, based on the same standards. Secondly, ESMA standards would also identify certain cases, where the authorisation process in Art. 22 would not be required due to the nature of the index.

The proposal helpfully establishes a specific regime for certain benchmarks (e.g., critical and commodities). We consider this partly-calibrated approach as heading in the right direction, since it goes someway to take into account market diversity. However, the current proposal is still applying the same set of rules to a great diversity of benchmarks, e.g., public and bespoke alike. (Bespoke indices may be designed for a limited number of sophisticated users. As such, they are not subject to the same systemic risks or regulatory concerns as those for public benchmarks widely used in the markets.) In **order to strike a necessary balance between integrity and adequacy, we suggest a two-step calibrated approach,** where the benchmarks authorisation process and an exemption (from the Regulation) would be based on ESMA standards.

Firstly, these standards would identify certain features of benchmarks (e.g., *de minimis* notional value; professional orientation), which would enable competent authorities to waive certain obligations (e.g., transparency in Art. 16, physical separation in Annex I Section A paragraph I 8(b)). This exemption would be allowed because, due to the characteristics of the relevant benchmarks, relevant obligations would be regarded by authorities as disproportionate, duplicative or onerous (economically burdensome). For instance, certain internal organisational requirements mentioned in the text, should not be obligatory below a certain notional value.

Secondly, ESMA standards would also identify certain administrator cases, where the authorisation process in Art. 22 would not be required due to the nature of the index, for instance, indexes based on public data, on other benchmarks or on an objective formula[3]. This second leg would scope 'out' benchmarks which, if subject to this Regulation, would create unnecessary workload for national competent authorities (NCAs). Additionally, in order to avoid any misuse, the relevant administrator would be simply required to notify ESMA of using such relief.

We believe that this approach would provide a sound legal framework, as well as reduce any unintended side effects caused by such wide scope (e.g., re-location of EU benchmarks overseas; dis-incentivising production; or costs passed on to final users).

[3] A formula which is linked 50%/50% to the revaluation of the shares of two different listed companies (an index computed as the average share price for two companies weighting 50% each), might be considered to be a benchmark and, therefore, the administrator would be obliged to be registered and to comply with the rest of requirements set forth in the EC Proposal.

Please refer to amendment 1 mentioned in the list.

3.2 - Definitions (Art. 3)

For legal clarity and certainty purposes, some clarifications and guidance should be provided for some key terms (e.g., 'made available to the public', 'benchmarks', and 'trading venue').

We note that the proposal establishes a very wide (and disproportionate) scope, since the term 'benchmark' (Art. 3.1.2) is based on a broad definition of 'Index' (Art. 3.1.1). This is partly because, 'made available to the public', one of the elements composing 'Index', is not clarified. For instance, the scope of 'benchmark' as currently defined – also taking into account the definition of 'user' – would capture indices referred to by managers of funds, where these indices are merely being referred to as a comparison against the performance of the fund – we wonder why such indices should be subject to the same level of regulation as, for example, LIBOR.

Although more guidance on this matter could be given via Commission delegated acts in Art. 3.2, we believe that for the sake of legal certainty, this assistance should be provided in Level I via an Article or Recital. In this regard, **Art. 14.2 of the Prospectus Directive**[4] (where the term 'made available to the public' is clarified) could deliver such necessary guidance. This should be adjusted to ensure that, where an index is made available only to a single or small group of fee-paying clients, it does not fall under the scope of the Regulation.

We believe that the main purpose of the proposal is to avoid any manipulation of benchmarks, mostly due to conflicts of interest affecting the administrator or the contributors of the benchmark. However, the text regulates some issues that are unnecessary to achieve such a goal. We believe that when subjectivity is predominant in the determination of the benchmark, many of the requirements included in the draft regulation seem appropriate. However, when the data feeding the benchmark are regulated data or released by a public institution, the proposed regulation does not seem to be appropriate. Please see point 3.1.

Also, in order to eliminate duplication of requirements, the definition of 'Index' in Art. 3.1 should exclude indices that are based on other benchmarks covered by this regulation (and therefore already subject to all relevant requirements). For example, an index composed of 50% CAC 40 (France) and 50% IBEX 35 (Spain), should not be subject again to the proposal requirements, since these two indices are already required to comply with them. Similarly, all of the input data of a top level index made up of several other 'sub' indices should be subject to the processes and checks set out in the Regulation, rather than separate

[4] Directive 2010/73 and subsequent amendments.
The prospectus shall be deemed **available to the public** when published either:
(a) by insertion in one or more newspapers circulated throughout, or widely circulated in, the Member States in which the offer to the public is made or the admission to trading is sought; or
(b) in a printed form to be made available, free of charge, to the public at the offices of the market on which the securities are being admitted to trading, or at the registered office of the issuer and at the offices of the financial intermediaries placing or selling the securities, including paying agents; or
(c) in electronic form on the issuer's website or, if applicable, on the website of the financial intermediaries placing or selling the securities, including paying agents; or';
(d) in an electronic form on the website of the regulated market where the admission to trading is sought; or
(e) in electronic form on the website of the competent authority of the home Member State if the said authority has decided to offer this service.

processes for each individual component as well as the top level index. For the same reason, the definition of benchmark should make clear, that measuring the performance of an investment fund does not include managed baskets. These types of indices are distinct from 'strategy' indices, and already governed by regulation.

Additionally, we welcome limiting the scope of traded financial instruments; however, it is not clear whether this applies only to Regulated Markets (RMs) and Multilateral Trading Facilities (MTFs), or also to all instruments required to be traded on future Organised Trading Facilities (OTFs). **We believe this should clearly refer to RMs and MTFs,** to ensure that only the most liquid products are in scope, and thus to be proportionate to how widely used a benchmark is.

Finally, for legal clarity, we recommend underscoring that the several criteria of the 'index' definition (in Art. 3.1.1) are cumulative, by adding 'and' at the end of each one. Otherwise, any of these criteria could be regarded as independent and alternative definitions of 'index'.

Please refer to amendment 2, 3 and 4 mentioned in the list.

3.3 - Critical benchmark (Art. 3.1.21, Art. 13 and Art. 14)

With the goal of reflecting real market developments, the definition of “critical benchmark” should be cumulative and based on qualitative and quantitative factors. Additionally, in order to avoid several harmful consequences for the benchmarks process (i.e., unfit contributors and inaccurate data), required contributors should be able to challenge the mandatory contribution detailed in Art. 14.

We believe that setting a fixed threshold related to a notional amount, as the most important criterion to determine a critical benchmark, can lead to significantly unfair situations. Such a setting is likely to be insensitive to market developments (due to the fixed amount), but also disregards the essence of the critical benchmark as set out in Recital 30 ("*The failure of certain critical benchmarks may have a significant impact on financial stability, market orderliness*."). Based on these reasons, we propose a cumulative definition based on qualitative and quantitative factors (e.g. adverse impact on markets). Additionally, the threshold definition does neither specify how the calculation of notional amount would be made nor the timeline to obtain this figure. In light of this, we suggest that the Commission provide such guidance via delegated acts in Art. 3.2.

Regarding the mandatory contribution for critical benchmarks in Art. 14, we recommend that required contributors would be able to object with reasonable arguments the determination of the competent authority. This would help to avoid very negative consequences not only for those entities contributing nowadays, and those that may be obliged to contribute in the future; but also for all market operators. In this regard, we would like to point out the following:

- Every supervised entity will be subject to mandatory contribution, not only actual contributors. Consequently, this obligation may impact on any market operator (regarded as supervised entity);
- If an supervised entity that does not have the infrastructure, capacity or knowledge to contribute, is nonetheless obliged to participate, this may affect the correct formation of the benchmark, as such entity's contribution may not correctly represent the market as intended.

- It is reasonable to assume that if the level of contribution falls by 20%, there would most likely be a reason for this situation, e.g., problems with the market or financial systems. Therefore, in such circumstance, mandatory contribution would most likely be inappropriate for the market and its full universe of participants.

Please refer to amendment 5, 6 and 15 mentioned in the list.

3.4 - Governance Requirements (Art. 5 and Annex I A - Section 1.8)

With the goal of reconciling calibration with adequate internal oversight**,** further guidance regarding data provided by the front office, should be given.

We welcome the recognition that some requirements should not apply to benchmarks produced using regulated data in Art.10 (e.g., code of conduct and panels of submitters) or are limited to 'critical benchmarks' only (e.g., mandatory participation and supervisory approval of code of conduct). However, further adjustments are needed to ensure that high standards of governance and internal controls are met, in a way that is feasible and appropriate considering the wide variety of benchmark produced in the EU.

In particular, Annex I Section A I points 6-8 are not always necessary (where a benchmark is produced entirely using regulated data) - or proportionate (for benchmarks which are not widely referenced in products by market participants) - or sometimes not even achievable - in the case of pre-submission controls for same-day automated indices. In order to address all of this, an amendment is needed, making the application only to benchmarks not produced using regulated data, and allowing post-submission verification where necessary. For example, we could assume that 'submission' means that another department submits data the front office requires to be submitted, or allows for post-hoc verification 'as soon as practicable', or even 'next day' where sooner is not possible, or where it would ultimately undermine the benchmark to verify before input data is submitted. This is in tandem with suggestions under point 3.1 above.

In particular, Annex I A - Section 1.8, states that administrators shall not accept input data from office functions, unless there are adequate oversight and verification procedures, including *"physical separation of employees in front office function and reporting lines"*. As a result, this could dis-incentivise some firms from contributing, since, in some cases, individual contributors need to have front office knowledge and expertise in order to make sensible contributions. Additionally, such pre-submission controls could lead to the discontinuance of many indices due to prohibitive costs.

Please refer to amendment 7, 8, 12, 24, 25 and 26 mentioned in the list.

3.5 - Administrators: Input data and methodology (Art. 7, Art. 3.1.11 and Art. 11)

In order to address some challenges posed by certain requirements in Art. 7.1, we propose that investment fund NAV shall be considered as Regulated Data (as per Art. 3.1.1), and the code of conduct shall explain how to verify if a market is competitive based on non-transaction data.

We would like to highlight the fact that the obligations in Art. 7.1a (data representing the market accurately and reliably), Art. 7.1b (obtaining the input data from a representative panel of contributors), and Art. 7.1c (verifying whether or not the input data represents a market subject to competitive supply and demand forces), appear difficult to implement and verify due to the diversity of benchmarks. This is especially the case where benchmarks are composed of prices in investment funds, as these funds only use the Net Asset Value (NAV[5]) published by the asset manager of the relevant fund as input data. Neither other fund managers, nor other market participants, have the capacity to provide an alternative. As a result, we wonder how the administrator would comply with 7.1b and 7.1c requirements.

In light of this, as an alternative, we suggest that investment fund NAV be considered as Regulated Data (as per Art. 3.1.11 and Art. 10), as management companies are already subject to regulatory valuation procedures, and to controls such as audits, price publication and methodology established in AIFM[6] and UCITs[7]. As a result, the asset manager acting as administrator would be exempted from Art. 7.1b.

In addition, Art. 7.1c requires the administrator to verify that the input data represents a market, subject to competitive supply and demand forces. However, given the nature of such information[8], (e.g., expert judgment and executable firm bids); an index administrator would have enormous difficulties complying, since such information is not public and therefore very difficult to access on an ongoing basis. As an alternative, we suggest that the administrator monitor this information, using the code of conduct referred to in Art. 9, where systems providing non-transaction data could be specified.

Regarding the powers granted to the administrator of the benchmark, we would like to insist on the importance of rejecting the possibility of assigning the administrator with extraordinary powers to supervise and to audit a data contributor. The entity empowered to request information or proceed with an investigation should be the national competent authority. In order to address this issue, article 11.3 should be amended accordingly.

Please refer to amendment 4, 13, 27 mentioned in the list.

3.6 - Reporting breaches (Art. 8)

Systems and effective controls to ensure the integrity of input data, shall take into consideration the specifics of the different type of benchmarks.

We note that this provision fails to take into account the characteristics of the various types of benchmarks. For example, Article 8 paragraph 2 requires the administrator to monitor input data and contributors, in order to identify any breach to the Market Abuse Regulation or any attempt to manipulate a benchmark. Where the administrator and contributors are in the same group, such monitoring may be more appropriate if conducted by an independent oversight body. Likewise, an independent oversight body may not always be necessary. This requirement should allow flexibility for how it is met, depending on the nature of the benchmark.

In light of this, we suggest an amendment to ensure that the manner, in which the internal controls are established, can be calibrated for different types of benchmarks.

Please refer to amendment 9 mentioned in the list.

[5] **Net asset value** (NAV) in the context of a fund is the total value of a fund's portfolio (its assets) less its liabilities.
[6] Art. 19 of AIFM.
[7] Art. 23.3 of UCITS.
[8] What is not covered by transaction data in Art. 3.1.12.

3.7 - Code of conduct (Art. 9)

Further clarifications should be given on whether the code of conduct requirement is applicable to benchmarks produced by using internal data. Moreover, contributors should be closely involved in the drafting of the code of conduct (which establishes control requirements for non-supervised contributors).

We welcome the provisions under Article 9, allowing benchmarks produced on the basis of regulated data to be exempted from the code of conduct requirement. However we question whether this provision (Art. 9), should also apply to benchmarks produced by using internal data, given that internal controls should ensure that conflicts of interest are sufficiently well-managed for these types of benchmarks. We are also concerned about the potential for multiple, duplicative codes of conduct; along with the provision that all of them be 'legally binding' - formally confirming this is a significant administrative burden that may not be commensurate with the benefit of participating as a contributor.

Moreover, obligations of the codes of conduct should not deter participants from contributing to a benchmark. Hence, contributors should be involved in the definition and drafting of the code of conduct, and should be consulted prior to the adoption of Commission delegated acts on the terms of the code. Thus, we recommend that Art. 9.2 explicitly mention that the administrator shall consult relevant contributors before adoption of the code of conduct.

Please refer to amendment 10 and 11 mentioned in the list.

3.8 - Regulated data (Art. 10)

Additional clarifications on reasons why the administrator and the contributor must enter into an agreement would be welcome.

We note that Art. 10.2 prescribes that the administrator and the contributor of the regulated data shall enter into an agreement. This will allow the contributor to know the benchmark the administrator is going to determine with such data. In this regard, we would like to have further explanation on such reasoning, since there is no similar requirement for administrators when data is provided by non-regulated data contributors.

Additionally, we support eliminating the double reporting of transactional data, and recommend instead to make effective use of established mechanisms - we encourage legislators to leverage existing reporting transaction channels under REMIT, MiFID and EMIR. Also, transaction-based benchmark data from trade repositories or regulators could be provided in an aggregated, anonymous manner.

3.9 - Transparency (Art. 15, 16 and 17)

Important clarifications are required, to know to what extent an administrator can disclose details of index methodology, without infringing intellectual property rights and confidentiality agreements.

In respect to transparency obligations, we would like to have more clarity on to what extent the administrator can disclose details of index methodology, without infringing intellectual property rights and confidentiality agreements. For instance, Bank 'X' pays index provider for a licence to use its index (either to replicate some/all weighting or to measure performance, alone or blended). Would Bank 'X' be obliged to disclose the methodology in full?

In light of this, we suggest introducing in Art. 15, an obligation to protect intellectual property rights and confidentiality agreements, when details of the methodology are disclosed by the administrator. Additionally, the code of conduct (Art. 9) as well as the benchmark statement (Art. 15), should introduce a clause in this regard as one of the required elements.

Our concern is that uncontrolled disclosure of such information can adversely and unfairly affect relevant contributors, as well as all market participants. Particular individual data may be mis-understood by the market as a potential problem or weakness of a contributor with respect to the specific market the data concerns (due to temporary treasury difficulties or any other reason). The risk is that quickly-taken market interpretation and further acts based on those un-considered views, can escalate a merely particular or transitory situation into a real crisis, not only for the relevant entity (e.g., diminished funding access), but also perhaps to that entire financial market or system.

Additionally, excessive disclosure of individual data provided by contributors, may negatively affect the quality of the benchmarks, by reducing incentives for market participants to contribute. If a number of contributors decide not to contribute anymore, because they are concerned about the confidentiality of their submissions, this will result either in a less-representative index, or to mandatory contribution on critical benchmarks, with the consequences mentioned in point 3.3 for contributors, non-contributors and the market as a whole.

Also, as mentioned in point 3.1, the text should include a calibrated regime for smaller-in house benchmarks, based on a limited asset base or other criterion. ESMA standards could spare many of these benchmarks from these obligations. Otherwise, we fear these costs would be passed on to the investor, making the activity uneconomical.

Please refer to amendment 16, 17 and 27 mentioned in the list.

3.10 - Equivalence of third-country administrators (Art. 20)

Unless we have a realistic and effective equivalence regime (based on the administrator compliance with IOSCO principles) , the EU economy will suffer several major harmful consequences (e.g., sudden withdrawal of liquidity in products referenced to a non-EU benchmark; serious undermining of European banks in hedging their FX risks vis-à-vis non-EU currencies, and comparative disadvantage for EU banks).

The text proposes in Art. 20 that an EU-supervised entity, may only use a benchmark produced by an administrator in a third-country jurisdiction, when the Commission has adopted an equivalence decision pertaining to that jurisdiction.

Here, we would like to comment on some key issues that our members have so far identified as concerns:

A - Non-EU jurisdictions as equivalent

We would like to outline **how difficult** it will be to regard any non-EU jurisdictions as equivalent, since most of them have not yet put in place any of the regulations needed to enable this (as specified by IOSCO[9] in its Principles report). In fact, in that document, IOSCO recommends members to consider, whether they should take regulatory action to encourage implementation of the Principles.[10] Moreover, the text mandates a review process starting 18 months after report publication, to assess how far the Principles have been implemented.

As a result, it is likely that many IOSCO members will be considering whether, or to what extent, any regulatory action on benchmarks should be taken. On top of this, such regulatory action may not take the form of legislation; and even if it does, it may not contain all provisions equivalent to those in the proposed Regulation.

In light of this, our concern is that the proposed equivalence process would essentially **be an obstacle preventing EU-supervised entities** from using non-EU benchmarks, since it is unclear whether any third-country jurisdiction will be able to put in place such an equivalence framework. The current proposal could thus be seen as a back-handed EU attempt to unilaterally impose its regulatory framework on third-country jurisdictions, irrespective of IOSCO Principles.

B - Negative effects

We would like to outline the harmful effects that Art. 20 could cause for EU financial markets. Based on the definition of 'user of a benchmark' (Art. 3.15), and other key provisions in the text (e.g., Art. 3.1.2 and Art. 20), users will only be allowed to issue, sell or hold positions in a wide range of products which reference non-EU benchmarks, if the administrator is duly authorised.

As previously mentioned, the proposed equivalence procedure is likely to seriously limit the availability of non-EU benchmarks within the EU. This would result in a significant reduction of benchmarks at the disposal of EU banks, investment firms, insurers, and corporates (via banks). For instance, use of common indices provided by non-EU exchanges, non-EU central banks (e.g., the US) or monetary authorities, as well as the TIBOR (Tokyo Inter-Bank Offered Rate), would be restricted, unless an equivalence decision is taken by the Commission (a very uncertain outcome, as noted above).

Our over-arching concern is that, unless the equivalence procedure is more realistic, i.e., focused on IOSCO Principles, the competiveness of EU companies, financial markets, and market choice in general, will be seriously undermined. In order to illustrate this, the following possibilities may be noted:

- A sudden withdrawal of liquidity in products referencing a non-EU benchmark;
- Supervised entities (currently using benchmarks provided by non-EU administrators) forced to sell existing holdings or to modify existing contracts - it is worth noting that the proposal does

[9] In the July 2013 IOSCO final report on Principles for Financial benchmarks, p. 7 - "The majority of IOSCO members do not currently regulate benchmark administrators or submitters."
[10] "Following the publication of the IOSCO Principles on benchmarks, IOSCO intends to review, within an 18-month period, the extent to which the Principles have been implemented."

not include any indication as to how and within what timeframe such entities should liquidate their positions, as there is no transitional framework for non-EU benchmarks;

- European banks' capacity to hedge FX risks vis-à-vis Asian economies, would be extremely limited (see examples in Annex I);
- Non-EU users operating in third-country jurisdictions would enjoy significant comparative advantage, since non-EU entities would be able to choose between benchmarks provided by administrators either in EU or in third countries; thus creating a non-level playing field to the disadvantage of EU market participants.

C - Intra-group requirements

It is of concern that there is a lack of clarity about how requirements would apply intra-group. It seems that an EU bank could not hold a position in a product referencing a non-EU benchmark in a branch outside the EU, even if it does not sell that product to EU investors. It is also unclear if a benchmark produced in a subsidiary outside the EU, although in line with the Regulation's requirements, could be sold within the EU. In addition, the Regulation implies, but does not state clearly, that even if a product is not traded on an EU venue, a non-EU benchmark could still be used inside the EU.

D - Solution

With this background, we propose more clarity regarding intra-group requirements. Furthermore, we suggest an alternatives to the current equivalence approach in Art. 20: A two-pillar approach founded on the IOSCO principles.

1- A regime, which is based on adequate implementation of the IOSCO Principles by the non-EU administrator. In this regard, the supervised entity or the non-EU administrator must demonstrate to ESMA that such compliance is effective (e.g. legal framework, supervisory and rules of administrators). If this is the case, ESMA shall introduce the relevant administrator into a special register that would allow it to be used in the EU. Additionally, ESMA will issue RTS clarifying the details of the register and how to demonstrate compliance with IOSCO principles.

2- Non-EU benchmarks can be provided in the EU, provided that IOSCO and ESMA have positively assessed the implementation of the IOSCO principles in their respective non-EU jurisdictions (via the corresponding review conducted 18 months after the Principles report publication).

Please refer to amendment 18, 19 and 20 mentioned in the list.

3.11 - Requirement for Authorisation (Art. 22)

For legal certainty purposes, the term '**intended to be used**' in Art. 22 should either be defined or deleted.

We consider that **'intended to be used'** in Art. 22 (one of the criteria for an EU administrator to apply for authorisation) poses a significant issue of lack of clarity. We note that the text neither defines 'intended to be used' in this context, nor provides any framework to determine when the intention has occurred.

Thus, we wonder how an administrator could verify the manner that one of his indices is intended to be used by a third-person (user), and therefore submit its application. Additionally, it is worth noting that Art. 4 and 25 provide a framework to exclude from the Regulation, not only administrators unaware of the use of benchmark provided, but also non-consenting administrators. However, in both provisions, such an exclusion framework is only triggered in the case of **'use'** ('intended to be used' is not mentioned as a condition)'.

Considering all this, we would suggest deleting 'intended to be used' and amending Art. 22, in order to provide legal clarity and certainty.

Please refer to amendment 21 mentioned in the list.

3.12 - Application for authorisation (Art 23)

In relation to Art. 23, we would welcome longer timeframes in order to comply with these administrative requirements.

Art. 23 provides that an administrator must submit an application for authorisation within 30 days from the date an agreement for use of its benchmarks has been entered into with a supervised entity, or from the date that an administrator has been notified of a use of one of its benchmarks. The relevant competent authority has 15 days upon receipt of an application, to notify completeness of the application, and then must adopt a decision within 45 days.

These timeframes seem unrealistic for both applicant administrators and relevant competent authorities. We would welcome longer timeframes in order to comply with these administrative requirements.

3.13 - Transitional framework (Art. 39)

The transitional framework in Art. 39 poses several significant problems (e.g., penalisation of users of non-EU benchmarks; uncertain conditions to meet; and a one-size-fits-all approach), which need to be addressed. Otherwise, there is risk of a major EU market dislocation and significant 'jump risk', due to an abrupt move from old benchmarks to successors.

We note that the proposal introduces a transitional framework for 24 months after the date of application of the Regulation, thus permitting for a time the use of existing benchmarks at the time of entry into force of the Regulation, but only if the administrator has applied for authorisation. Also, Art.39.3 lists several cases (i.e., force majeure, frustration, and breach of a contract), where existing benchmarks that do not comply with the proposal requirements are allowed to use this transitional framework. In this regard, Art. 39.4 helpfully proposes an arrangement (although undefined in time), to manage transition when Art. 39.3 is triggered: "*The use of a benchmark shall be permitted by the relevant competent authority of the Member State where the administrator is located* ***until such time*** *as the benchmark references financial instruments and financial contracts worth no more than 5% by value of the financial instruments and financial contracts that reference this benchmark at the time of entry into force of this Regulation."*

However, having said this, we would like to point out several issues worth addressing, for the sake of a progressive and smooth transition, which, if not achieved, will certainly lead to **major EU market**

disruption and significant **'jump risk'**, in the case there is an abrupt move from old benchmarks to successors:

- Firstly, Art. 39 only applies to benchmarks produced by EU administrators (*'authorisation under Article 23'*). Our concern is that the proposed framework would penalise users of non-EU benchmarks, given that no transitional provisions are foreseen for administrators established in a third country (even where relevant benchmarks comply with cases listed in Art. 39.3). As a result, use of non-EU benchmarks would be **abruptly suspended, with no prospect of progressive transition from old benchmarks to successors**. This seems inconsistent with the general approach of the text, which explicitly recognises the international nature of benchmarks (e.g., Recital 34[11] and 40[12]; extraterritorial scope in Art. 2; and the equivalence process in Art. 20).

- Secondly, more granularity is needed for the transitional process mentioned in Art. 39.3 and 39.4. Further guidance and clarity is highly recommended, in order to know what steps should be followed by administrators so that they can benefit from this transitional process (e.g., how to prove that frustration has occurred) and to users so that they can cease to issue new instruments but continue to hold existing instruments during the two year authorisation window, regardless of whether the administrator has already applied for authorisation or not. It is uncertain how the relevant competent authority is expected to assess whether the 5% threshold (in Art. 39.4) has been crossed; or an event of *force-majeure*, frustration or breach of contract terms has occurred; since neither Art. 39 nor Art. 23 provide any details in this regard. Additionally, the text uses the term 'would' instead of 'could', which requires 100% certainty, which is very challenging to demonstrate. It is not clear how market participants could be sure that a force majeure event 'will' in fact occur, whereas wording such as 'could', or 'could reasonably be expected to' (i.e., possibility), is a more suitable solution. In light of all this, our fear is that any smooth transition would be hindered by such an unclear and uncertain framework.

- Thirdly, there is a one-size-fits-all approach when applying the transitional framework. We note that Art. 39 does not take into account different calibration factors, which otherwise underpin the proposal (e.g., 'critical benchmark' or sectoral requirements in Art. 12). These factors helpfully calibrate regulation requirements, to the risks and specifics of different types of benchmarks, in order to make the proposal work. Given this, we would welcome introducing such a proportional approach in applying the transitional framework to specific benchmarks (e.g., a critical benchmark). Additionally, IOSCO Principles recognise such an approach in Principle 13 (Transition): *"These policies and procedures should be* ***proportionate*** *to the estimated breadth and depth of contracts and financial instruments that reference a Benchmark and the economic and financial stability impact that might result from the cessation of Benchmark*".

[11] "This Regulation should take into account the Principles for financial benchmarks issued by **the International Organization of Securities Commissions (IOSCO) (hereinafter referred to as 'IOSCO Principles'),** on 17 July 2013, which serve as a global standard for regulatory requirements for benchmarks. Following the publication of the Principles, IOSCO intends to review within 18-month period the extent to which the Principles has been implemented."

[12] "Some of the provisions of this Regulation apply to natural or legal **persons in third countries,** who may use benchmarks or be contributors to benchmarks, or may be otherwise involved in the benchmark process. Competent authorities should therefore enter into arrangements with supervisory authorities in third countries. ESMA should coordinate the development of such cooperation arrangements, and the exchange between competent authorities of information received from third countries."

- Fourthly, there remains risk of frustration or breach of contract terms, despite the current framework. It is of concern that, due to the 5% trigger, issuers face the risks mentioned in Art. 39.3 (e.g., frustration) when complying with the Regulation. In order to address this, we recommend allowing the indices referred to in this article, to be used until the termination of the financial agreement or the maturity of the financial instrument.

- Finally, similar transitional arrangements will also be needed whenever an index becomes a benchmark or a benchmark becomes a critical benchmark.

Considering the above, we propose extending the transitional framework to administrators established outside the EU. Also, we suggest providing more clarity and certainty regarding the transitional framework (e.g., steps to take and conditions to meet), introducing a calibrated approach vis-à-vis certain benchmarks (e.g., critical ones) via ESMA, and allowing indices covered by Art. 39 to be used until the termination of the financial agreement or the maturity of the financial instrument.

Please refer to amendment 20, 22 and 23 mentioned in the list.

3.14 - Annex II and III (Interest Rates and Commodities benchmarks)

The proposal goes into very technical details of the commodity and interest rates benchmarks in Level 1 (details provided in the relevant annexes), which could create a set of unintended consequences (e.g., difficulties in updating relevant provisions). In light of this, we would suggest leaving technical details in Annex II and III to Level 2 (and Level 3).

We would like to note that the proposal indeed goes into the very technical details of the commodity and interest rates benchmarks in Level 1, with details provided in the relevant annexes. We consider that such level of granularity should be provided in another level (e.g., ESMA Level 2 measures), where adequate technical discussions and consultations could take place. Otherwise, significant problems may be posed: If new developments or issues occur, the Level 1 positioning would render it very inflexible. Only delegated acts could change some aspects of the annexes (Art. 12.3). The Level 1 approach would also make the legislative discussions rather difficult, since very technical issues would be subject to a political debate (EP and the Council). In light of this, we would suggest leaving details in commodities and interest rates annexes to Level 2 (and Level 3), where proper technical discussions could take place at length. Please refer to amendment 14 mentioned in the list.

Annex I - Benchmarks: List of examples regarding third-country regime

Example 1

UK Corporate A has a number of Asian businesses, the biggest of which is in Korea. UK Corporate A funds this entity centrally so it can obtain the cheapest cost of funds. However, this leads to a currency mismatch as UK Corporate A Plc has GBP centrally, but its Korean operations need KRW. Therefore UK Corporate A enters into a KRW[13]-denominated inter-company loan, which it hedges back to GBP. This means UK Corporate A Plc doesn't take any currency risk, and UK Corporate A's Korean entity gets the funding it requires in the correct currency.

To hedge the currency risk UK Corporate A enters into a GBP-KRW Cross Currency Swap with Bank Z in Seoul. This swap is cash settled in GBP, as KRW is a non-deliverable currency. At every interest payment date and maturity of the swap, the KRW amount that is due on the swap is actually settled in GBP. The GBP amount is determined by using the index KFTC18 USD-KRW fix crossed with the index 8am WMR fix for GBP-USD.

If the KFTC18 fixing source was not available, UK Corporate A would not be able to hedge its FX risk in putting in place a KRW denominated loan. This would mean UK Corporate A would not be able to put in place inter-company funding and so would have to fund its Korean business through local debt facilities.

If companies were no longer able to hedge these FX risks, it would open them up to a huge amount of market risk, and therefore they would have to either accept this risk or decide not to enter into the underlying contract.

Example 2

On the asset side, Company C provides financing to its clients in local currency. Interest is calculated using local fixing, and then interest and principal are both paid to Company C in local currency. This company therefore needs to swap these revenues back into USD (its functional currency).

On the liability side, Company C funds its overseas businesses in local currency where possible, in order to achieve the lowest cost of funds. The currency mismatch at the parent level is then hedged through cross currency swaps back into USD. Currently Company C has AUD[14], CAD[15], INR[16], MXN[17] fixed or floating bonds (non-exhaustive list).

On a daily basis, this company's balance sheet management, enters into multiple cross-currency basis swaps in order to manage its currency exposure arising from its daily activity.

[13] South Korean Won.
[14] Austrian dollar.
[15] Canadian dollar.
[16] Indian rupee.
[17] Mexican peso.