

Level-2 measures under the Benchmarks Regulation

Committee on Economic and Monetary Affairs Scrutiny Session of 8 June 2017

This briefing has been drawn up to support ECON's work on the scrutiny of delegated acts, in particular for the discussion of 8 June 2017 on Level-2 measures under [Regulation \(EU\) No 2016/1011](#) on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds¹.

In brief

On 30 June 2016, the Benchmarks Regulation (**BMR**) entered into force. As of 1 January 2018, most of the rules² for entities providing benchmarks, contributing input data to a benchmark or using a benchmark, will start to apply. BMR empowers the Commission to adopt delegated acts (**DAs**) and implementing acts (**IAs**), including Regulatory and Implementing Technical Standards (**RTS** and **ITS**), for which preparatory work was carried out by the European Securities and Markets Authority (ESMA). This briefing provides an overview of selected issues, which are expected to be covered in the forthcoming Level-2 measures, including – for the DAs – the definition of what constitutes ‘making available to the public’, quantitative and qualitative criteria for categorisation of the benchmarks, the transitional provisions, and – with regard to the RTS – rules on input data and the authorisation/registration of an administrator.

DELEGATED ACTS (DAs)

The DAs under BMR cover technical specifications of certain definitions (‘making available to the public’, ‘administering the arrangements for determining a benchmark’ and ‘issuance of financial instrument’), the measurement of the reference value of a benchmark, the criteria referred to in Article 20(1)(c) subparagraph (iii), the endorsement of third-country benchmarks for EU use and the transitional provisions.

Definitions: ‘making available to the public’ (Article 3 BMR)

The most important definition, which is expected to be specified by the Commission in the forthcoming DAs is the notion of ‘**making available to the public**’. This notion is a key element of the definition of a ‘benchmark’ under BMR, and hence frames the scope of BMR – notably including benchmarks that are of wider public interest, while excluding bespoke indices. ESMA’s Technical Advice (TA) uses the wording

¹ Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014, OJ L 171, 29.6.2016, p. 1–65.

² BMR contains transitional provisions for (i.) existing EU entities that provide indices and (ii) third-country entities that provide indices already used in contracts or instruments in the EU. In these cases, the full application of BMR is set to start on 1 Jan. 2020. Furthermore, the rules on the procedure for designating critical benchmarks, the mandatory administration of and contribution to such benchmarks and the functioning of the supervisory colleges related to such benchmarks are applicable since 30 June 2016.

'accessible to a potentially indeterminate number of persons' and does not set a quantitative threshold for the number of recipients of an index. This implies that any restriction in accessibility (e.g. those indices individually agreed with a limited number of clients) would result in the indices' exclusion from the definition of 'made available to the public', and from BMR's scope. ESMA's TA also specifies the arrangements for 'access to an index', i.e. directly or indirectly, and through a variety of media and modalities, whether free of charge or not.

Quantitative and qualitative criteria for categorisation of the benchmarks (Article 20)

Designating critical benchmarks

The Commission can designate benchmarks as critical by means of an implementing act establishing a list. To date this list includes only the Euribor (Implementing Regulation (EU) 2016/1368). An amendment of this Regulation to add the EONIA to the list of critical benchmarks is expected to be adopted by the Commission shortly.

BMR classifies benchmarks into critical, significant and non-significant, based on two types of criteria:

- **Quantitative thresholds** that are linked to the reference value of financial instruments, financial contracts or measuring the performance of investment funds (EUR 500 bn for critical benchmarks and EUR 50 bn for significant and non-significant benchmarks).
- **Qualitative criteria** that are linked to the availability of appropriate substitutes, or the likelihood of '*significant and adverse impact on market integrity, financial stability, consumers, the real economy or the financing of households or businesses*' in cases where (i) the provision of the benchmark ceases or (ii) the benchmark is provided based on unreliable input data, or no longer fully represents the underlying market or economic reality.

Whilst, in ESMA's TA the elements of both criteria are specified with regard to critical benchmarks, they will also concern other categories of benchmarks due to the identical wording is used in the BMR for them.

Regarding the **quantitative threshold**, the TA sets out the calculation methods for the reference value for different types of financial instruments. ESMA reviewed data collected under existing legislation and recommends the use of data collected under EMIR, MiFID II, UCITS, and AIFMD. As data collection under some of these legal acts will start after the BMR's date of application, ESMA proposes a **fall-back regime** to be used for as long as data is not yet available or insufficient. Under this regime, administrators may use data from alternative private providers of information or open interest data calculated and published by market operators. As for the **qualitative criteria**, ESMA proposes a non-exhaustive list of criteria, taking into account the specific type of benchmark or market.

Endorsement of third-country benchmarks for use in the EU (Article 33)

Third-country benchmarks can be used EU-wide, e.g.³, when endorsed by an EU entity subject to certain conditions. In particular, the BMR requires 'an objective reason' for the provision of a benchmark in a third-country and for the endorsement for use in the EU - a requirement ultimately intended as an anti-avoidance mechanism to prevent loopholes being introduced via third-countries⁴. ESMA's TA proposes a non-exhaustive list of criteria that NCAs should take into account when assessing whether to allow the endorsement of a third-country benchmark. This list includes objective reasons for:

- The **provision** of a benchmark of family of benchmarks in a third-country, namely: geographical proximity, specific skills required in the benchmark provision and legal or other restraints to obtain input data.
- The **use** of a third-country benchmark or family of third-country benchmarks in the EU, namely: effects on both benchmarks users and potential benchmark users in the EU.

³ Benchmarks provided by third-country entities can also be used in the EU, where an equivalence decision has been taken (Article 30 BMR) or where the third-country administrator has been recognised (Article 31 BMR).

⁴ Similar provisions can be found in the CRA Regulation and AIFMD and their implementing measures.

Transitional provisions (Article 51)

EU index providers already operating on 20 June 2016 have until 1 January 2020 to apply for authorisation and registration, and transitional provisions allow for continued provision and use of the index until that date or until application is refused. For existing contracts, BMR also allows an NCA to grant permission for continued use of a benchmark beyond that point of time, if ceasing or changing the benchmark 'would result in a force majeure event, frustrate or otherwise breach the terms of a financial contract or financial instrument or the rules of any investment fund which references that benchmark'. The TA sets out a non-exhaustive list of conditions under which an NCA can allow such continued use.

REGULATORY TECHNICAL STANDARDS (RTS)

The RTS under BMR mainly cover the **governance arrangements** for benchmark administrators (oversight function, input data, methodology and its transparency and benchmark statement) and for contributors (code of conduct, governance and control of supervised contributors), as well as criteria for add-on requirements by NCAs for administrators of significant benchmarks and the information to be included in the application for authorisation and registration and for recognition of third-country administrators. The ITS provide templates for the compliance statement and rules on procedures and forms for exchange of information between NCAs and ESMA.

Characteristics and procedures of the oversight function (Article 5)

The objective of these draft RTS is to **ensure integrity and absence of conflicts of interests** and they set out details and requirements for the oversight function, as regards:

- Its **composition**, i.e. in accordance with the ownership and control structure of the administrator, including a list of possible arrangements that is annexed to the RTS.
- Its **positioning** within the administrator's organisation, i.e. embedded within the organisational structure but separate for management and governance functions.
- Its governing **procedures**, i.e. minimum procedures for an oversight function, including disclosure of conflicts of interest but excluding the obligation to publish names of members and meeting minutes as initially included in the Consultation Paper.

Input data (Article 11)

These draft RTS specify how to ensure **the appropriateness and verifiability of input data** and what procedures should be in place to ensure that input data obtained from a front office function is subject to **oversight and verification procedures**. The draft RTS embed certain proportionality for some benchmarks, with stricter requirements for critical benchmarks, and more flexibility for some requirements taking into account the nature, scale and complexity of the activities of the contributors and the level of discretion in the contribution process.

Transparency of methodology (Article 13)

These draft RTS contain **key elements to be disclosed by benchmark administrators on their methodologies**. Depending on the type of benchmark, the draft RTS allow some administrators to opt out of certain disclosure requirements. The draft RTS furthermore specify disclosure of some information on the **internal review of the methodology** as well as of the procedures for consulting on **material changes in the administrator's methodology**.

Code of conduct for contributors (Article 15)

In view of the higher risk for the integrity of benchmarks based on contributions, the benchmark administrator must require that the contributors adhere to a code of conduct. The draft RTS further specify the elements herein, e.g., rules on the description of input data, on submissions by contributors and on policies to ensure that input data is relevant. Policies on the **use of discretion** when contributing input data are also required, to counter the risk of data manipulation.

Governance and control requirements for supervised contributors (Article 16)

For supervised contributors, specific governance and control requirements are provided. In particular, controls on **submitters** include sign-off processes of their contributions, verifications of their knowledge and measures to avoid conflicts of interest. Remuneration of the submitters, for example, should not be linked to the benchmark or specific values of the submissions, nor to the performance of a specific activity of the supervised contributor that may raise a conflict of interest with the contribution to the benchmark.

Qualitative criteria for significant benchmarks (Article 25)

ESMA was also asked to develop draft RTS that further specify the **nine criteria** that NCAs may use to determine that an administrator of a significant benchmark should not be allowed to opt out of certain requirements of BMR ('add-ons'). ESMA proposes minimum requirements for each criterion of the level-1 text for NCAs to assess, including elements on the vulnerability of the benchmark to manipulation, the nature of the input data and the importance of the benchmark for financial stability.

Benchmarks statement (Article 27)

The draft RTS defining the minimum content of the **benchmark statements** include general disclosure requirements for all benchmarks, contents to be included depending on the type of benchmark (regulated-data, interest rate, commodity, critical, significant and non-significant benchmarks) and changes in the benchmark or its methodology, which give rise to an update of the statement.

Authorisation and registration of an administrator (Article 34)

These draft RTS contain two annexes on information to be provided in **the application for authorisation and for registration**. The provisions explicitly distinguish between the information to be provided for each type of benchmark. There are some small differences in the information required for authorisation compared to registration, mainly in the way in which the information is to be provided (in a summary form). Concerning the transitional provisions that may apply, ESMA in its final report called on the Commission to provide interpretative guidance.

Recognition of third-country administrators (Article 32)

The last draft RTS included in ESMA's final report specify the information that an **application for recognition of third-country benchmarks** should contain. They also require for applicants to explain their choice of the specific Member State (MS) of reference and the identity and role of the appointed legal representative in that MS.

OVERVIEW AND TIMELINE OF THE PREPARATORY WORK

	COM request for TA	ESMA Discussion Paper	ESMA Consultation Paper	ESMA Final TA and Report
DAs	8 February '16	15 February '16	27 May '16	10 November '16
RTS/ITS	n.a.		29 September '16	30 March '17 and 1 June '17

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