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Mr Tilman Lueder
Head of Securities Markets Unit
DG FISMA, European Commission
Rue de Spa 2
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December 20, 2019

Re: Feedback on draft directions on Financial Benchmark Administrators

Dear Mr. Lueder,

The Asia Securities Industry & Financial Markets Association ("ASIFMA") and the Global Foreign Exchange Division ("GFXD") of the Global Financial Markets Association welcomes the opportunity to provide comments to the European Commission consultation on the effectiveness of the EU Benchmarks Regulation ("BMR").

ASIFMA is an independent, regional trade association with over 100 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, professional service firms, law firms and market infrastructure service providers. It harnesses the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia.

ASIFMA advocates stable, innovative, competitive and efficient Asian capital markets that are necessary to support the region's economic growth. It drives consensus, advocates solutions and effects change around key issues through the collective strength and clarity of one industry voice. ASIFMA is based in Hong Kong and is the Asia member of the GFMA.

The GFXD was formed in co-operation with the Association for Financial Markets in Europe, Securities Industry and Financial Markets Association and ASIFMA. Its members comprise 25 global foreign exchange (FX) market participants[1], collectively representing a significant portion of the FX inter-dealer market. Both the GFXD and its members are committed to ensuring a robust, open and fair marketplace and welcome the opportunity for continued dialogue with global regulators.

The FX market is the world's largest financial market and effective and efficient exchange of currencies underpins the world's entire financial system. The FX market is also the basis of the global payments system. The volume of transactions is therefore very high, and these transactions are often executed by market participants across geographical borders.

Many of the current legislative and regulatory reforms have had, and will continue to have, a significant impact upon the operation of the global FX market, and the GFXD wishes to emphasise the desire of its members for globally coordinated regulation, which we believe will be of benefit to both regulators and market participants alike.

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We support the European Commission's ("EC") consultation on the effectiveness of the BMR as part of its preparation of a report for the European Parliament and the Council due on 1 April 2020.

In addition to the responses provided to the questions in the consultation, we have also provided as additional information the following documents:

1. The EU Benchmarks Regulation and the APAC Region – Keeping up the Momentum
2. Non-EEA Benchmarks
3. BMR Third Country Regime – INR Example

Summarised below are a number of the key recommendations we have made in our submission to the EC's consultation:

[1] Bank of America Merrill Lynch, Bank of New York Mellon, Barclays, BNP Paribas, Citigroup, Crédit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan, Lloyds Bank, Mizuho, Morgan Stanley, MUFG Bank, NatWest Markets, Nomura, Northern Trust, Royal Bank of Canada, Scotiabank, Standard Chartered Bank, State Street, UBS, Wells Fargo and Westpac.

Proportionality

Recital 40 of the BMR emphasises the importance of proportionality and ensuring that an excessive administrative burden is not placed on administrators of benchmarks whose cessation poses less threat to the wider financial system. Similarly, the IOSCO Principles note the importance of ensuring the proportionality of the application of the Principles to the size and risks of each benchmark and administrators.

As noted by ESMA's own Securities and Markets Stakeholders Group in its response to an ESMA consultation on its Guidelines for Administrators of Non-Significant Benchmarks, a lack of proportionality could act as a barrier for entry to providers of non-significant benchmarks (see Annex 1 - The EU Benchmarks Regulation and the APAC Region – Keeping up the Momentum).

Non-Significant Benchmarks

Given that non-significant benchmarks are unlikely to impact on the market integrity financial stability, consumers, the real economy or the financing of households and businesses in the EU or individual Member States, this is indicative of the poor calibration of the current regulatory framework applicable to non-significant benchmark providers, and on this basis we recommend that all non-significant benchmarks should not be required to gain authorisation and can continue to be used by EU supervised entities under the BMR after the transition date (see Annex 2 - Non-EEA Benchmarks).

We are supportive of the existing quantitative threshold applied to critical benchmarks. However, we recommend that the EC consider increasing the current quantitative threshold for significant benchmarks from a total average value of EUR 50 billion over six months to EUR 100 billion over the same period on the basis that, at this level, non-significant benchmarks would not have an adverse impact on the market integrity or financial stability of a Member State.

FX Forwards

FX products, in particular non-deliverable forwards ("NDFs") and non-deliverable options, are used by EU entities (e.g. pension funds and manufacturers) to hedge currency exposures arising from investments or exports/imports with emerging market economies. A 2018 survey showed that between 38% and 52% of global volumes traded in three Asian NDFs - KRW, TWD and PHP - were traded by EU entities. Prohibiting EU supervised entities from using these products will have several significant adverse effects, including:

- Fewer liquidity providers and a likely increase in costs for end-users able to sign-up with a non-EU liquidity provider;

- EU supervised entities with local onshore exposures will be unable to hedge their currency risk and will most likely have to withdraw from those markets causing potential market instability (see Annex 3 - BMR Third Country Regime – INR Example);
- Risk of market fragmentation; and
- EU supervised entities will no longer be able to act as a source of funding for Asian entities using swaps referencing NDF benchmarks.

Therefore, we recommend the adoption of the approach previously proposed by the EC to expand the definition of 'public authorities' under the BMR to include third-country administrators of FX Spot rates in non-convertible and pegged currencies so that local central banks would be deemed the de facto administrators and as such outside the scope of the BMR.

Continued Use of Non-compliant Benchmarks

The ability to continue to use a benchmark where authorisation has been withdrawn is crucial to mitigating the impact on the market of such withdrawal, including by avoiding contract frustration/termination, or the need to renegotiate a contract which relied on such a benchmark. It is also required in order to be able to management the risks associated with legacy positions to avoid potential loses being incurred by clients or to avoid carrying unhedged risk. Even where alternative benchmarks are available, their use could expose supervised entities to basis risk.

Benchmark/Index Published or made available to the Public

There is no differentiation between a proprietary benchmark administered by a supervised entity for a small number of professional clients, and a benchmark published on a public forum, on a commercial basis and widely available for use by the public.

It is unreasonable to treat 'proprietary' benchmarks in the same way as those published on public forums. Therefore, 'proprietary' benchmarks should be excluded from scope on the basis that regulating such benchmarks does not provide any additional consumer protection.

Financial Instrument Scope

A 'financial instrument' is defined as being traded on a trading venue ("TOTV"), submitted to be TOTV, or traded by a Systematic Internaliser ("SI"). This definition results in a scope that is:

- Broader than the trading transparency requirements set out under MiFID II;
- Practically unworkable because of a lack of visibility as to whether an SI might have traded an instrument that is not TOTV.

We recommend that the reference to SI's should be removed from the definition of financial instrument

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We greatly appreciate the opportunity to share our views on the Directions. Please do not hesitate to contact John Ball on+ 852 2531 6512, email jball@gfma.org should you wish to discuss the above.

Yours sincerely,

Mark Austen	James Kemp
CEO	Managing Director
ASIFMA	Global Foreign Exchange Division, GFMA

Public consultation: Review of the EU benchmark regulation

Critical benchmarks

IBOR reform

Question 3: Are there any other changes to Article 23(6)(d) BMR relative to the change of methodology for critical benchmarks that might be desirable to improve the robustness, reliability or representativeness of the benchmark?

Yes

Question 3.1: Please explain your reply to question 3.
2000 character(s) maximum

If a benchmark no longer represents the underlying market then Article 23(6)(d) should be utilised where the underlying interest is no longer relevant, but the methodology could be revised in order to produce an economically equivalent outcome.

Where the use of Article 23(6)(d) is not feasible, orderly cessation would be the only option.

Orderly cessation of a critical benchmark

Question 4: To what extent do you think that benchmark cessation plans should be approved by national competent regulators?
Please rate from 1 (completely disagree) to 5 (fully agree)

2

Question 4.1: Please explain your reply to question 4.
2000 character(s) maximum

Given the proposal in the ESA Review that ESMA will be the sole supervisor of administrators of critical benchmarks, we do not consider it appropriate for national competent authorities to approve benchmark cessation plans for critical benchmarks. If these plans are to be approved by any supervisory body, the most appropriate body to provide such approval is ESMA.

Question 5: Do you consider that supervised entities should draw up contingency plans to cover instances where a critical benchmark ceases to be representative of its underlying market?

Yes

Question 5.1: Please explain your reply to question 5.
2000 character(s) maximum

As acknowledged by the EC in the consultation paper, the underlying objective of article 28(1) is to 'avoid disruption to users and financial markets when benchmarks…are materially changed'. We consider that this concept of 'material change' includes situations in which a critical benchmark ceases to be representative of its underlying market. However, there is no uniform definition of ‘material change’ and each benchmark administrator must determine when this occurs and how it will communicate this change to users. If the EC believes that there is a gap, it may be preferable to ensure it is covered within ‘material change’ definition.

As such, it is appropriate for supervised entities, particularly in the context of concerns about market preparedness to deal with IBOR discontinuation, to prepare contingency plans for circumstances where a critical benchmark ceases to be representative of its underlying market.

In addition, users will have contingency plans for situations other than cessation. The trigger point for the use of these plans should be driven by supervisory authorities. Otherwise, different supervised users could trigger contingency plans at different times, leading to market disruption.

Colleges

Question 6: To what extent do you consider the system of supervision by colleges as currently existing appropriate for the supervision of critical benchmarks?
Please rate from 1 (not appropriate at all) to 5 (very appropriate)

3

Question 6.1: If you consider the system of supervision by colleges as currently existing not appropriate, what changes would you suggest?
2000 character(s) maximum

Given the proposal in the ESA Review that ESMA would be the sole supervisor of administrators of critical benchmarks going forward, we consider there to be significant uncertainty as to how colleges would function going forward.

We would welcome guidance from the EC as to how it is envisaged that the system of supervision by colleges will intersect with ESMA's new responsibility for critical benchmarks.

Authorisation, suspension and withdrawal

Question 7: Do you consider that it is currently unclear whether a competent authority has the powers to withdraw or suspend the authorisation or registration of an administrator in respect of one or more benchmarks only?
Please rate from 1 (very unclear) to 5 (very clear)

2

Question 7.1: Please explain your reply to question 7.
2000 character(s) maximum

It is unclear on the face of Article 35 as to whether a competent authority would have the power to withdraw or suspend the authorisation or registration of a single benchmark.

We recommend that competent authorities (in respect of non-critical benchmarks) should have the power to withdraw/suspend authorisation or registration at the benchmark or even family of benchmark level rather than at the administrator level, as this would provide competent authorities with a degree of flexibility and would mitigate the impact on the market of any suspension/withdrawal of authorisation or registration.

We also recommend that ESMA have such power in respect of critical benchmarks, provided that this is made clear to the market.

Continued use of non-compliant benchmarks

Question 8: Do you consider that the current powers of NCAs to allow the continued provision and use in existing contracts for a benchmark for which the authorisation has been suspended are sufficient?
Please rate from 1 (totally insufficient) to 5 (totally sufficient)

1

Question 8.1: Please explain your reply to question 8.
2000 character(s) maximum

The continued use of a benchmark where authorisation has been withdrawn is crucial to mitigating the impact of such withdrawal, including by avoiding contract frustration/termination, or the need to renegotiate a contract which relied on such a benchmark.

The BMR should be amended to allow:

- Management of risks associated with legacy positions using benchmarks authorisation has been suspended/withdrawn for a period of 12 months, or longer provided the supervised entity makes an application for an extension on reasonable grounds to its NCA, after the suspension or withdrawal. Some legacy positions will have residual maturities in excess of 12 months that require rebalancing on a regular basis rather than terminated to avoid potential loses being incurred by clients or to avoid carrying unhedged risk. Where alternative benchmarks are available, their use could expose supervised entities to basis risk;
- Automatic grandfathering of suspended/withdrawn third-country benchmarks in legacy contracts unless explicitly forbidden by ESMA, who under the ESA review will become the supervisor for non-EU benchmarks. This would align the procedure with Article 51 (4) concerning the use in legacy contracts of unauthorised non-EU benchmarks, i.e. automatic grandfathering without the need to ask for NCA's authorisation; and
- The use by supervised entities of benchmarks, other than those that are non-significant, administered by third-country administrators whose applications for registration are pending approval, both before and after 1 January 2022 until their application is approved or for a period of 12 months after 1 January 2022, whichever is the shorter. This would significantly reduce the impact of the commencement date, particularly with the significant pressure to repaper to address the discontinuation of LIBOR.

We recommend that 51(4) should include consideration of the detrimental impact of termination of the contracts to end users.

Question 9: Do you consider that the power of competent authorities to permit continued use of a benchmark when cessation of that benchmark would result in contract frustration are appropriate?

Please rate from 1 (not appropriate at all) to 5 (very appropriate)

5

Question 9.1: Please explain your reply to question 9.

2000 character(s) maximum

We consider these powers to be important, as otherwise the suspension of a benchmark's authorisation is likely to often serve as a de facto withdrawal of that authorisation. This power to permit the continued use of benchmarks in these circumstances provides:

- Supervised entities with an ability to continue to be able to manage the risk associated with legacy positions; and
- a grace period for administrators to seek the reinstatement of their authorisation while ensuring that their rates can be used in the meantime.

Scope of the Benchmark Regulation

Question 10: Do you consider that the regulatory framework applying to non-significant benchmarks is adequately calibrated?
Please rate from 1 (not well calibrated at all) to 5 (completely adequately calibrated)

1

Question 10.1: Which adjustments would you recommend? Please explain your reply to question 10.
2000 character(s) maximum

Recital 40 of the BMR emphasises the importance of proportionality and ensuring that an excessive administrative burden is not placed on administrators of benchmarks whose cessation poses less threat to the wider financial system. Similarly, the IOSCO Principles note the importance of ensuring the proportionality of the application of the Principles to the size and risks of each benchmark and administrators.

Article 26 states that an administrator of a non-significant benchmark may choose not to apply certain elements of Articles 4, 5, 6, 7, 11, 13, 14, 15 and 16 of the BMR. However, as was noted by ESMA's own Securities and Markets Stakeholders Group (SMSG) in its response to an ESMA consultation on its Guidelines for Administrators of Non-Significant Benchmarks (Guidelines), administrators of non-significant benchmarks must still comply with similar requirements as administrators of significant benchmarks in relation to other key areas – for example, oversight functions, accountability frameworks, complaints handling, record keeping, and outsourcing.

As noted by the SMSG, this lack of proportionality could act as a barrier for entry to providers of nonsignificant benchmarks.

Given that non-significant benchmarks are unlikely to impact on the market integrity or financial stability of the EU or individual Member States, we consider this indicative of the poor calibration of the current regulatory framework applicable to non-significant benchmark providers, and on this basis recommends that all non-significant benchmarks should not be required to gain authorisation and can continue to be used by EU supervised entities under the BMR after the transition date.

It is also worth noting that non-significant benchmarks demonstrate compliance with IOSCO principles, and in other jurisdictions only the most systemic or critical benchmarks.

Question 11: Do you consider quantitative thresholds to be appropriate tools for the establishment of categories of benchmarks (non-significant, significant, critical benchmarks).
Please rate from 1 (not appropriate at all) to 5 (completely appropriate)

3

Question 11.1: Please explain your reply to question 11. If applicable, which alternative methodology or combination of methodologies would you favour?
2000 character(s) maximum

We are supportive of the existing quantitative threshold applied to critical benchmarks. However, we recommend that the quantitative threshold associated with significant benchmarks be increased to EUR 100 billion on the basis that, at this level, non-significant benchmarks would not have an adverse impact on the market integrity, financial stability, consumers, the real economy or the financing of households and businesses in a Member State. Given the issues experienced by third-country administrators in accessing data about the usage of their benchmarks within the EU in the context of applying for recognition in their member state of reference, we consider it appropriate for the BMR to continue to include qualitative criteria focused on a benchmark’s impact on market integrity/ financial stability as part of these definitions. However, there needs to be greater clarity on what the qualitative criteria, such as market integrity/ financial stability, are assessed.

We also consider it important that the EC recognise the limited adverse impact that the majority of third-country benchmarks may have on market integrity, financial stability or consumers in a Member State. All passive fund investments are market-weighted according to the major bond and equity indices maintained by the established index providers, e.g. Bloomberg, FTSE Russell, IHS Markit, MSCI, S&P, Refinitiv, all of which appear on the ESMA register required under Article 36. Although there is no publicly available data, the exposure of EU supervised entities to other third-country emerging market indices, based on the total Assets Under Management of individual funds, is small by comparison.

Question 12: Do you consider the calculation method used to determine the thresholds for significant and critical benchmarks remains appropriate?
Please rate from 1 (not appropriate at all) to 5 (completely appropriate)

4

Question 12.1: Please explain your reply to question 12. If applicable, please explain why and which alternatives you would consider more appropriate?
2000 character(s) maximum

The current methodology based on a simple total average value over a six-month period is the simplest methodology available to both regulators and administrators provided it is based on transactions reported to the European trade repositories.

However, consolidated trade repository data is only available to ESMA and not market participants. It has become clear during the transition period as third-country administrators have sought to identify their member state of reference for the purposes of recognition that there is no "golden source" of data in the public domain from which to determine the usage of a benchmark in the Union. This has been particularly problematic for certain third-country administrators who operate without a commercial, for profit, business model. Consequently, we recommend that ESMA should be responsible for determining whether a benchmark is critical, significant or non-significant.

Further, we recommend that the EC consider increasing the current quantitative threshold for significant benchmarks from a total average value of EUR 50 billion over six months to EUR 100 billion over the same period. We consider this to be a more appropriate threshold to use as a means to capture benchmarks whose discontinuation or material change would have a significant and adverse impact on one or more Member States.

Question 13: Would you consider an alternative approach appropriate for certain types of benchmarks that are less prone to manipulation?
Please rate from 1 (not appropriate at all) to 5 (completely appropriate)

5

Question 13.1: If you would consider an alternative approach appropriate for certain types of benchmarks that are less prone to manipulation, please explain for which types.
2000 character(s) maximum

Where the input data is regulated at its source (i.e. through regulation of contributors) then it is appropriate to reduce the regulatory burdens applicable to these benchmarks under the BMR.

We would recommend that in addition to the examples of regulated trading venues provided in the BMR, i.e. certain trading venues, electricity exchanges, natural gas exchanges, auction platforms, the definition is expanded to include indices or rates where the benchmark administrator has no financial interest in the performance of contracts referencing the index, e.g. equity indices.

ESMA register of administrators and benchmarks

Question 14: To what extent are you satisfied with your overall experience with the ESMA register for benchmarks and administrators?
Please rate from 1 (not satisfied at all) to 5 (completely satisfied)

2

Question 14.1: Please explain your reply to question 14.
2000 character(s) maximum

As acknowledged by the EC in the consultation paper, users of the register have raised concerns regarding the functioning of the register. This is consistent with the experiences of the members of ASIFMA and the GFXD, who consider the register could be improved by:

- allowing for filtering of benchmarks by category (i.e. critical/significant/non-significant benchmarks);
- including the following additional information:
  i. the status of applications for authorisation or registration that are under consideration;
  ii. those benchmarks where the authorisation has been withdrawn, the date such notice was issued and the details of supervisory action;

iii. including a link to the benchmark statement; and
iv. the ISINs of benchmarks where available (the use of ISINs should be encouraged as the monitoring of authorised EU benchmarks is currently very complicated (with subsequent operational risk) due to inconsistencies arising from the need to rely solely on benchmark names.

Question 15: Do you consider that, for administrators authorised or registered in the EU, the register should list benchmarks instead of/in addition to administrators?
Please rate from 1 (completely disagree) to 5 (fully agree)

5

Question 15.1: Please explain your reply to question 15.
2000 character(s) maximum

The Register should list benchmarks in addition to administrators (and allow for filtering / searching by benchmark as well as by administrator) on the basis that:

i. An administrator may specifically wish to exclude certain benchmarks from use in the Union; and
ii. The authorisation of an individual benchmark rather than an administrator may be withdrawn. However, the current Register does not allow for this to be displayed.

Benchmark statement

Question 16: In your experience, how useful do you find the benchmark statement?
Please rate from 1 (not useful at all) to 5 (very useful)

5

Question 16.1: Please explain your reply to question 16.
2000 character(s) maximum

The view of the members of ASIFMA and the GFXD is that a benchmark statement at family level remains the most user-friendly approach.

There are a number of issues associated with the requirement for all benchmarks to provide ESG disclosures.

Recital (16) of the climate-benchmarks Regulation that states: “to ensure that the labels ‘EU Climate Transition Benchmark’ and ‘EU Paris-aligned Benchmark’ are reliable and easy for investors across the Union to recognise, only administrators that comply with the requirements laid down in this Regulation should be eligible to use those labels when marketing EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks in the Union.”

This creates a burden on innovative, yet very small, ESG Benchmarks creating the possibility that many ESG benchmark administrators would not be able to fulfil the methodological requirements of the Carbon benchmarks regulation.

In addition to the above labels, two additional categories of ESG classification exist:

i. ESG benchmarks unable to fulfil the requirements of the regulation but pursuing ESG objectives
ii. Benchmarks not pursuing ESG objectives

Some ESG benchmarks could not be classified as ESG compliant without them fully applying the regulatory requirements for Carbon Benchmarks. Therefore, they would be deemed as non-ESG compliant in a similar way to those that do not pursue ESG objectives. Currently, most benchmarks neither fulfil the requirements of the EU Carbon benchmarks regulation nor pursue ESG objectives.

Consequently, we recommend that ESG benchmark administrators publish a separate document alongside their benchmark statement that outlines the ESG aspects of the benchmark.

Question 17: How could the format and the content of the benchmark statement be further improved?
2000 character(s) maximum

Guidance from ESMA as to what it perceives to be best practice may be helpful to administrators in publishing high quality, easy to read statements.

Question 18: Do you consider that the option to publish the benchmark statement at benchmark level and at family level should be maintained?
Please rate from 1 (should definitely be removed) to 5 (should definitely be maintained)

5

Question 18.1: Please explain your reply to question 18.
2000 character(s) maximum

This option should be maintained so to reduce the administrative burden on benchmark administrators. Removing this option would significantly increase the administrative burden on larger administrators who may administer thousands of benchmarks. We also consider the use of benchmark statements for families of benchmarks to be more user friendly than requiring individual statements for each benchmark (particularly where individual benchmarks may be close to identical to other statements in their family). Without this option, the volume of statements from an administrator will likely become repetitive and unmanageable as well as potentially be overwhelming for users.

However, where statements are used for families of benchmarks, there is a need to differentiate benchmarks within the same family in order to determine their ESG status and whether they have been classified as non-significant.

Commodity benchmarks

Question 21: Do you consider the current conditions under which a commodity benchmark is subject to the requirements in Title II of the BMR are appropriate?
Please rate from 1 (not appropriate at all) to 5 (completely appropriate)

4

Question 21.1: Please explain your reply to question 21.

2000 character(s) maximum

The general application of the BMR related to commodity benchmarks is considered reasonable.

Under Article 19, Title II of the BMR will apply if a commodity benchmark is either a regulated-data benchmark, the majority of contributors are supervised entities or if it is a critical benchmark and the underlying asset is gold, silver or platinum. Given the level of trading in these precious metals, it is extremely unlikely that they will be classified as critical benchmarks.

It should be noted that the precious metals market has limited liquidity compared to other financial markets and benchmarks are determined by auction methodology rather than being trade based. However, the benchmarks for all four precious metals are registered by the London Metals Exchange (LME), an authorised administrator under the BMR, and are categorised as non-critical commodity benchmarks that are subject to Annex II of the BMR.

Question 22: Do you consider that the compound de minimis threshold for commodity benchmarks is appropriately set?
Please rate from 1 (not appropriate at all) to 5 (completely appropriate)

3

Question 22.1: Please explain your reply to question 22.
2000 character(s) maximum

The current “compound de minimis” threshold is too low particularly for gold. Over 100k oz is frequently traded either side of the benchmark so, assuming there is no “netting”, this is significantly more that the current threshold. In addition, there is no consideration given to seasonal variations.

Non-EEA benchmarks

Question 23: To what extent would the potential issues in relation to FX forwards affect you?
Please rate from 1 (not at all) to 5 (very much)

5

Question 23.1: If the potential issues in relation to FX forwards would affect you, how would you propose to address these potential issues?
2000 character(s) maximum

Non-deliverable forwards (NDFs) and options are used by EU entities (e.g. pension funds and manufacturers) to hedge currency exposures arising from investments or exports/imports with emerging market economies (see attached: ‘BMR Third Country Regime – INR Example’). A 2018 survey showed that between 38% and 52% of global volumes traded in three Asian NDFs - KRW, TWD and PHP - were traded by EU entities.

There are at least seven NDF currencies all of which will be in scope of the regulation because they will either be traded on a trading venue (TOTV), submitted to be TOTV or traded by a Systematic Internaliser.

Prohibiting EU supervised entities from using these products will have several significant adverse effects, including:

- fewer liquidity providers and a likely increase in costs for end-users able to sign-up with a non-EU liquidity provider;
- EU supervised entities with local onshore exposures will be unable to hedge their currency risk and will most likely have to withdraw from those markets causing potential market instability;
- risk of market fragmentation;
- EU supervised entities will no longer be able to act as a source of funding for Asian entities using swaps referencing NDF benchmarks.

Therefore, we recommend the adoption of the approach previously proposed by the EC to expand the definition of 'public authorities' under the BMR to include third-country administrators of FX spot rates in non-convertible and pegged currencies so that local central banks would be deemed the de facto administrators and as such outside the scope of the BMR.

EU supervised entities also use non-deliverable interest rate swaps to hedge onshore exposures. These products use domestic interest rates to determine the coupon payments due in the non-deliverable currency which are then converted into to USD using the NDF rate. We recommend that the treatment of administrators for restricted currencies as public authorities be applicable to all instruments referencing a FX spot rate.

Question 24: What improvements in the above procedures do you recommend?
3000 character(s) maximum

Given the overarching principle of proportionality in the BMR and IOSCO Principles, we recommend significant amendments be made to the existing application of the BMR to third-country administrators. In particular:

Significant benchmarks

We recommend the quantitative threshold for significant benchmarks be increased to EUR 100 billion and that the burden of the requirements, liability and accountability imposed on legal reps and endorsing agents be reduced to encourage firms to act in this capacity and reduce the cost for administrators. Many third-country administrators still do not consider recognition or endorsement to be viable options given the level of fees and control they would need to surrender (see attached: The EU Benchmarks Regulation and the APAC Region).

Non-significant benchmarks

Non-significant benchmarks are unlikely to impact the market integrity/stability of the EU or individual Member States. Therefore, all non-significant benchmarks should be exempt from authorisation and can continue to be used in the EU after the transition date.

Also, non-significant benchmarks should be able to opt-in to being authorised. There is recognition that authorisation validates the integrity of a benchmarks required by investors.

In the alternative, all non-significant benchmarks should be:

- exempt from scope where they are used by EU professional counterparties. However, if they are used in products sold to retail investors, there should be a warning by means of disclosure;
- able to be authorised by only requiring independent third-party verification of their compliance with the IOSCO Principles.

This approach is appropriate because non-significant benchmarks are highly unlikely to pose a significant threat to the market integrity/financial stability of the EU.

Benchmark/Index Published or made available to the Public

There is no differentiation between a proprietary benchmark administered by a supervised entity for a small number of professional clients, and a benchmark published on a public forum, on a commercial basis and widely available for use by the public.

It is unreasonable to treat 'proprietary' benchmarks in the same way as those published on public forums. Therefore, 'proprietary' benchmarks should be excluded from scope on the basis that regulating such benchmarks does not provide any additional consumer protection.

Financial Instrument Scope

A 'financial instrument' is defined as being traded on a trading venue (TOTV), submitted to be TOTV, or traded by a Systematic Internaliser (SI). This definition results in a scope that is:

- broader than the trading transparency requirements set out under MiFID II;
- practically unworkable because of a lack of visibility as to whether an SI might have traded an instrument that is not TOTV.

We recommend that the reference to SI's should be removed from the definition of financial instrument.

ANNEX 1

The EU Benchmarks Regulation and the APAC Region: Keeping Up the Momentum

Co-authored by ASIFMA and Herbert Smith Freehills

December 2019

DEVELOPING ASIAN CAPITAL MARKETS

1 EXECUTIVE SUMMARY

The two year extension to the EU Benchmarks Regulation (**BMR**)'s transitional period for third country benchmark administrators (**Non-EU Administrators**) to 31 December 2021 has given some welcome breathing space to both these administrators and users of their benchmarks within the European Union (**EU**). As highlighted in our earlier reports, the complexity and uncertainty surrounding the three avenues for third country registration – equivalence, recognition and endorsement – had generated significant industry concern about whether it would be possible to achieve a smooth transfer to the BMR before the original end to the transition period on 31 December 2020. However, this extension has created new difficulties, with the transition period now scheduled to end on the same day as LIBOR is due to be discontinued. This will create a "perfect storm" of regulatory change for benchmark administrators and users as we approach the end of 2021.

Despite the extended transition period, seeking registration for benchmarks still remains a significant challenge. This was made clear by the results of the third survey by ASIFMA and HSF of Non-EU Administrators across the Asia-Pacific (**APAC**) region. Our October 2019 survey indicated that although Non-EU Administrators have warmly welcomed the two year grace period, there is still a clear need for more guidance from the European Securities and Markets Authority (**ESMA**) and the European Commission (**Commission**), particularly given that the proposed changes to the regime under the European Supervisory Agencies Review have yet to come into force under EU law.

As such, Non-EU Administrators who wish to become BMR-compliant continue to encounter practical difficulties in relation to equivalence, recognition and endorsement. This is concerning for both regulators and the market, given the potential for significant disruption if widely used third country benchmarks are no longer available. In the APAC region, a recent survey of members of the Executives' Meeting of East Asia-Pacific Central Banks (**EMEAP**) showed that regulators are concerned that the failure of Non-EU Administrators to seek registration under the BMR could potentially force EU supervised entities to exit certain markets due to the unavailability of funding and hedging instruments in EMEAP markets.

Likewise, Non-EU Administrators surveyed by ASIFMA and HSF indicated that the most likely impact if they were not able to obtain registration for their benchmarks before the end of the transition period was that some funding and hedging instruments would no longer be issued, given that a significant majority of counterparties to these instruments are EU supervised entities.

This paper considers each of the persistent difficulties encountered by Non-EU Administrators in relation to each of the three options available to them for seeking registration of their benchmarks: equivalence (as addressed in Section 3), recognition (Section 4) and endorsement (Section 5).

It is clear from the results of our survey that Non-EU Administrators continue to face many of the same issues that they have struggled with our first survey in 2017. However, the complexities of the issues encountered by these Non-EU Administrators as they seek to have their benchmarks registered for use within the EU from 1 January 2022, have been further magnified against a backdrop of major market uncertainty relating to Brexit, the current status of the ESA Review and the upcoming discontinuation of major interest rate benchmarks such as LIBOR.

2 EU CONSULTATION PROVIDES AN OPPORTUNITY FOR FURTHER CHANGE

While the two year extension to the BMR transition period has given the industry and regulators a very welcome grace period to grapple with the reforms, many questions still remain, as discussed further below. Although the Commission has previously indicated that it does not intend to make any significant revisions to the rules under the BMR, there does appear to be some regulatory appetite to explore ways to make the regime more effective, efficient and simple to administer for Non-EU Administrators.

To this end, the Commission in October 2019 released a consultation paper (**October 2019 Consultation Paper**) on the effectiveness of the BMR regime, as part of its preparation of a report for the European Parliament and the Council due on 1 April 2020 (as mandated by article 54(1)(b) of the BMR). This October 2019 Consultation Paper is aimed at assessing the need for amendment of the BMR, although we note that the Commission has previously indicated that it does not intend to propose significant reforms to the substance of the BMR. Responses to the Consultation Paper are requested by 31 December 2019 and we would encourage interested parties to make submissions.

In light of the above, regulators and Non-EU Administrators across the APAC region are encouraged to continue with their efforts to engage further with their European counterparts regarding the difficulties facing Non-EU Administrators, in order to bolster market awareness and readiness for the reforms. Market participants are also encouraged to take steps to review their use of benchmarks, including by identifying fall-back rates that could be used in the event that currently used benchmarks fail to obtain registration by 1 January 2022.

3 RECENT CHANGES TO THE SCOPE AND OPERATION OF THE BMR

Since our October 2018 report, the Commission has helpfully clarified various aspects of the operation of the BMR, following widespread feedback from both EU and non-EU market participants.

The European Supervisory Authorities Review

In April 2019, the EU Parliament approved the Commission's proposed further changes to the ESA Regulations (the **ESA Review**). Relevantly, the ESA Review provided ESMA with new supervisory powers, including the power to act as sole authorising body for Non-EU Administrators. Once enacted, this will remove the need to identify a Member State of Reference as part of the process for applying for recognition. As discussed further below in section 3, the ESA Review has also resulted in proposed changes to the equivalence regime set out in the BMR.

However, as at the date of publication of this report, the European Council has yet to approve the final version of changes to the ESA Regulations for publication in the Official Journal of the European Union, and it is unclear exactly when the Council intends to do so. In any event, the removal of the requirement to identify a Member State of Reference will not take effect until after the end of the transition period for Non-EU Administrators and as such will not benefit these administrators in their efforts to obtain recognition before the end of the transition period.

Exceptions to the BMR – public authorities

Section 2 of the BMR provides an exemption for central banks, as well as public authorities (such as national statistics agencies) and persons or entities performing public administrative functions or providing public services (such as measures of employment and economic activity) under the control of a government entity.

However, the scope of this exemption has been the subject of frustration across the APAC region. This is because it is not uncommon for benchmarks in APAC to be administered by bodies that, whilst they have traditionally had close engagement with central banks, and/or were established specifically to assume the role of benchmark administrator from central banks and/or regulators, are not in fact public authorities under the current BMR definition. As such they will fall outside the scope of the exemption under the BMR.

For this reason, ASIFMA and its members have warmly welcomed the Commission's September 2019 indication that it would introduce an amendment to the definition of '*public authorities*' which would expand the definition to include Non-EU Administrators of FX spot rates in relation to currencies which are not fully convertible. This is in recognition of the fact that emerging market currency FX spot rates are often the result of sovereign interventions (such as exchange controls, currency pegs or FX management by local central banks), such that local central banks should be considered the de facto administrator of the rate.

While the Commission is in the process of consulting (through the October 2019 Consultation Paper) on this proposed amendment, we consider the Commission's earlier observation that it considers such an amendment necessary to '*align the playing field*' between Non-EU Administrators and EU Administrators to be a promising indication that this amendment will be included in the broader package of amendments which are likely to be forthcoming as a result of the consultation process. The enactment of this amendment is of particular relevance to the APAC region and will mean that EU supervised entities will be able to continue using FX spot rates for a number of emerging market currencies across the region after 31 December 2021, regardless of whether their administrators seek registration of these rates.

4 ISSUES WITH EQUIVALENCE

Given the difficulties associated with recognition and endorsement, as discussed below, equivalence has emerged as the most feasible option for Non-EU Administrators seeking registration of their benchmarks in the EU, with 50% of Non-EU Administrators surveyed indicating that they understood that their regulator intended to apply for equivalence.

However, while the Commission has helpfully published equivalence decisions for a number of APAC jurisdictions, most notably Australia and Singapore, there are still a number of challenges associated with this avenue.

Scope of equivalence decisions

The legislative and regulatory regimes implemented in Australia and Singapore only cover a certain sub-set of the benchmarks provided in those jurisdictions (mainly systemically important interest rate benchmarks), and as such, the equivalence decisions issued by the Commission do not cover all benchmarks provided in these jurisdictions. We note that Australia's regime, like New Zealand's recently enacted regime, does allow administrators to opt-in to the regime, which we consider a welcome feature of both regimes. However, regulators in jurisdictions such as Korea and India, which are currently in the process of implementing benchmarks legislation, have indicated that they intend to limit the scope of their regulatory oversight to a very small number of benchmarks considered by these national regulators to be domestically significant. Notably, only 33% of Non-EU Administrators surveyed who indicated that their jurisdiction would seek equivalence indicated that all their rates would be covered by the proposed equivalence decision, with 66% indicating either that only some or none of their rates would be covered. Given these survey results, it is hard to escape the conclusion that a significant number of Non-EU Administrators are likely to need to rely on recognition and endorsement. This issue was identified by the Commission in its October 2019 Consultation Paper, which noted that equivalence may not allow for continued use of 'the majority of indices administered outside the Union'.

To that end, the Commission has called for suggestions to improve the equivalence procedure under the BMR. Given that the scope of third country legislative regimes is a matter for third countries rather than the Commission (and given the Commission's apparent level of interest in the issue, as noted above), opportunities to improve the equivalence procedure may be limited. However, it does highlight the need for recognition and endorsement to serve as feasible alternatives for those Non-EU Administrators which may fall outside the scope of their national regimes. Non-EU Administrators face further difficulties in countries where multiple domestic regulators have jurisdiction over different types of benchmarks; for example, where equities benchmarks are supervised by a securities regulator and interest rate benchmarks are supervised by a banking regulator. These jurisdictions are likely to require separate equivalence decisions covering the different categories of benchmarks, which adds to the complexity and timeframe for any equivalence decision.

Assessing equivalence

Adding further complexity is the considerable uncertainty in the market as to precisely what is required to obtain equivalence, and the criteria the Commission will use in determining whether the relevant legislation or regulation is equivalent to the BMR.

Whilst the ESA Review has helpfully clarified that ESMA's role will be to provide advice to the Commission in preparing equivalence decisions when requested, there still remains some confusion as to the exact criteria the Commission will apply in making those decisions, beyond the IOSCO Principles for Financial Benchmarks. Worryingly, neither the Commission nor ESMA have publicly released any guidance that sets out what regulators must do in order to demonstrate that the regime ensures compliance with the IOSCO Principles. There are some limited indications that the Commission is providing such assistance privately and on an ad hoc basis, with one Non-EU Administrator surveyed indicated that the Commission had so far been '*very helpful*' in assisting with the equivalence process. However, one other Non-EU Administrator indicated that it would welcome more detailed guidance regarding the factors the Commission and ESMA will consider in relation to equivalence decisions.

5 ISSUES WITH RECOGNITION

While a majority of Non-EU Administrators surveyed by ASIFMA and Herbert Smith Freehills in July 2017 indicated that recognition was their preferred option for seeking registration, just 14% of those surveyed just over a year later in August 2018 indicated it was their preferred option. However, it is apparent from our October 2019 survey that sentiments have shifted yet again, with 50% of those surveyed Non-EU Administrators who indicated that they would seek registration indicating that they preferred recognition. Positively, the same proportion also indicated that they had taken significant steps towards recognition by engaging an external auditor to conduct an assurance review on compliance with the IOSCO Principles for Financial Benchmarks.

However, it is clear that recognition still presents significant challenges, including in relation to identification of a Member State of Reference and engaging a legal representative located in that Member State of reference.

Notably, the German Federal Financial Supervisory Authority (**BaFin**) (which we understand to be currently assessing a number of recognition applications from Non-EU Administrators across APAC) has stated that identification of the Member State of reference continues to be the main obstacle for national competent authorities and Non-EU Administrators. BaFin has also noted that communication challenges with ESMA have posed difficulties from a timing perspective.

While the ESA Review has proposed (as discussed above) that ESMA will act as the sole competent authority for Non-EU Administrators, eliminating the requirement to identify a Member State of reference, it does not appear that this will take effect until after the end of the transition period for Non-EU Administrators. Importantly, ESMA's 11 December 2019 briefing on the recognition process clearly still contemplates the identification of a Member State of reference in the recognition process, given that the briefing provides welcome guidance to administrators in identifying their Member State of reference. Additional complications stem from Brexit as well as timing issues, which are discussed further below.

Engaging a legal representative in the Union

As discussed in our previous reports and noted by the Commission in its October 2019 Consultation Paper, the type and scope of roles and responsibilities which must be assumed by a legal representative has had a significant impact of the feasibility of recognition for most Non-EU Administrators. In our most recent survey, while 50% of Non-EU Administrators surveyed indicated that they had begun searching for a legal representative in their Member State of reference, only 16% had successfully engaged a legal representative. A number of those surveyed indicated that cost, as well as a lack of interest from potential legal representatives, had been significant obstacles in their search for a firm to take on this role.

Impact of Brexit

Consistent with the results of our previous surveys, a number of Non-EU Administrators indicated that they considered their Member State of reference to be the UK. This creates an added level of complexity for these Non-EU Administrators, given the continued uncertainty regarding the timing of the UK's departure from the EU, as well as the duration of any transitional arrangements. As at the time of publication of this report, the UK had been granted a ‘flextension’ until 31 January 2020 to allow for the passage of the withdrawal agreement by the UK Parliament. The withdrawal agreement itself provides for a transition period (during which, relevantly, the EU BMR will continue to apply in the UK) until 31

December 2020, with the possibility of this transition period being extended for up to two years.

This second extension, as well as the results of the UK election held on 12 December 2019, make a no-deal exit significantly less likely, although it still remains a possibility.

Helpfully given this uncertainty, both the UK Financial Conduct Authority (**FCA**) and ESMA have issued guidance clarifying the impact of a no-deal Brexit for Non-EU Administrators, since our October 2018 report.

In March 2019, ESMA stated that in the event of a no-deal Brexit, any third country benchmarks recognised or endorsed in the UK before 31 October 2019 will be removed from the ESMA Register, and EU supervised entities will only be able to use these benchmarks until 31 December 2021. If there are no transitional arrangements in place for those Non-EU Administrators registered with the FCA, it seems likely that these administrators will either need to seek recognition from the EU member state that becomes their Member State of reference after Brexit, or ESMA once the ESA Review becomes enacted into EU law. Given this current state of uncertainty in relation to the timing of both Brexit and the enactment of the ESA Review's reforms to ESMA's role, it is unsurprising that none of the Non-EU Administrators surveyed had identified their Member State of reference post-Brexit.

However, Non-EU Administrators will also need to consider whether they wish for their benchmarks to be used within the UK (as well as within the EU) post-Brexit. Given London's status as a financial centre, we anticipate that many Non-EU Administrators are likely to do so.

The FCA has stated that in the event of a no-deal Brexit, the UK will introduce a 'UK Benchmark Regulation' (**UK BMR**), which will replicate the existing EU BMR framework but will apply only in the UK. Under the UK BMR, a new UK register will be established by the FCA and will operate in parallel with the existing ESMA Register. From Exit Day (and subject to the proposed transitional provisions discussed below) UK supervised entities will only be able to use benchmarks which are on the UK register. Practically, this means that Non-EU Administrators will also have to seek registration to have their benchmarks used in the UK, in addition to the EU – essentially doubling registration and compliance costs for Non-EU Administrators.

However, at the time of publication of this report, the UK Parliament had recently enacted a transitional period for the UK BMR, which will allow UK supervised entities to continue to use EU27 and other third country benchmarks until 31 December 2022. While this transitional period will not remove the additional burdens imposed on Non-EU Administrators as a result of needing to register their benchmarks in both the UK and the EU, it will at the very least provide a reasonable grace period to allow them to pursue registration in the UK. This is likely to mean that we see Non-EU Administrators pursue registration in the EU as a priority before 31 December 2021, with applications for registration in the UK taking place during the course of 2022 prior to the end of the UK transition period on 31 December 2022.

6 ISSUES WITH ENDORSEMENT

The final registration option available to Non-EU Administrators is endorsement. This option requires an administrator located within the EU, or another EU supervised entity with a 'clear and well-defined role' within the accountability framework of the relevant Non-EU Administrator (**EU Endorsing Entity**) to 'endorse' a non-EU benchmark.

Unlike recognition, endorsement does not require that an EU Endorsing Entity be located in a Member State of reference, and from this perspective endorsement may on paper appear to be a more viable option for Non-EU Administrators than recognition, particularly given the issues outlined above in relation to identifying a Member State of reference.

However, at the time of publication, only one Non-EU Administrator had achieved registration through endorsement, and the administrator in question relied on its Dutch affiliate in doing so. Further, based on the results of our October 2019 survey, it appears unlikely that we will see a significant number of Non-EU Administrators pursue this option, with none of the survey participants indicating that they intended to pursue endorsement. This limited interest is consistent with the level of attention paid to endorsement by the Commission in its October 2019 Consultation Paper, which only refers to endorsement very briefly, and clearly portrays it as the least significant or popular of the three options for registration for Non-EU Administrators.

As set out in our earlier papers, endorsement imposes the significant obligations on the EU Endorsing Entity under the BMR, including that:

- the EU Endorsing Entity needs to have verified, and be able to demonstrate on an ongoing basis to its own regulator, that the provision of the non-EU benchmark fulfils requirements at least as stringent as those set out in the BMR; and
- the EU Endorsing Entity needs to have the necessary expertise to monitor the activity of the provision of the non-EU benchmark by the Non-EU Administrator, and manage the associated risks.

Given these obligations, it is unsurprising that none of the Non-EU Administrators surveyed said they considered it feasible for an EU Endorsing Entity to be able to demonstrate that the provision of the non-EU benchmark fulfils requirements at least as stringent as those set out in the BMR, while just 16% of Non-EU Administrators surveyed considered it feasible for the EU Endorsing Entity to monitor the activity of the provision of the non-EU benchmarks.

Further, while 16% of Non-EU Administrators surveyed said that they have had preliminary discussions with firms that could potentially act as EU Endorsing Entities, such discussions have been hampered further by concerns about the legal liability associated with acting in this capacity. Under article 33(4) of the BMR, an endorsed benchmark shall be considered to have been provided by the EU Endorsing Entity, which will be considered 'fully responsible for the benchmark and for compliance with the obligations' imposed by the BMR.

We anticipate that this responsibility will continue to be a significant deterrent to would-be EU Endorsing Entities, or that taking on such endorsement will mean that the prices they charge to take on such a role are significant. The degree of responsibility which Non-EU Administrators would need to surrender to EU Endorsing Entities was also identified by some of the Non-EU Administrators surveyed as a deterrent from pursuing endorsement, particularly given that EU Endorsing Entities may in some cases be competitors of the Non-EU Administrators. For this reason, we consider it likely that endorsement will be a viable option only for those Non-EU Administrators with EU benchmark administrators or EU-supervised entities within their corporate groups, as seen in the case of the only Non-EU Administrator to successfully rely on endorsement to date.

Given the above, endorsement remains highly unlikely to be a viable registration option for a large number of Non-EU Administrators.

Non-EEA benchmarks

Recital 40 of the BMR emphasises the importance of proportionality and ensuring that an excessive administrative burden is not placed on administrators of benchmarks whose cessation poses less threat to the wider financial system. Similarly, the IOSCO Principles note the importance of ensuring the proportionality of the application of the Principles to the size and risks of each benchmark and administrators.

Given this overarching principle of proportionality, GFMA/ASIFMA recommends significant amendments be made to the existing application of the BMR to third-country administrators. In particular, we recommend:

1) Significant benchmarks:

We recommend that the quantitative threshold for significant benchmarks be increased to EUR 100 billion over six months.

In addition, we recommend that:

1. measures should be taken to reduce the burden of the requirements, liability and accountability imposed on legal representatives under article 32(3) and on endorsing entities under article 33(1), and in doing so, increase the willingness of firms to act as legal representatives and endorsing entities; and
2. similarly, streamlining the endorsement and recognition processes including, for example, by removing the requirement under article 33(1)(c) for applicants for endorsement to identify an "objective reason" to provide the benchmark in a third-country and for the benchmark to be endorsed for use in the EU.

These amendments are necessary as a significant number of third-country administrators are industry bodies with low profit margins. As a result, many third-country administrators do not consider recognition and endorsement to be viable options given the level of fees and control we understand endorsing entities and legal representatives have sought due to concerns about the liability/risk involved (see attached additional information: The EU Benchmarks Regulation and the APAC Region: Keeping Up the Momentum).

A 2018 survey of the GFXD's members showed that between 38% and 52% of global volumes traded in three Asian non-deliverable forwards (NDFs) (USD/KRW, USD/TWD and USD/PHP) were traded by EU entities.

NDFs and non-deliverable options, of which there are at leastbseven currencies not administered by their central bank. In addition to the above, they include INR, ARS, NGN and KZT, all of which would be in scope of the regulation because they will either be traded on a trading venue (TOTV), submitted to be TOTV or traded by a Systematic Internaliser. These products are used by EU entities (e.g. pension funds, asset managers and manufacturers) to hedge currency exposures arising from investments or exports/imports with emerging market economies (see attached additional information: 'BMR Third Country Regime – INR Example').

Preventing EU supervised entities from using these NDFs will have a number of significant adverse effects, including:

- fewer liquidity providers and costs will likely increase for end-users that are able to sign-up with a non-EU liquidity provider;
- EU supervised entities with local onshore exposures will be unable to hedge their currency risk and will most likely have to withdraw from those markets. This is likely to create market instability;
- creating the risk of market fragmentation;
- prohibiting EU supervised entities acting as a source of funding for Asian entities using swaps based on third-country benchmarks including NDFs will effectively close a source of funding for Asian entities.

As such, the GFMA/ASIFMA recommends the adoption of the approach previously proposed by the EC to expand the definition of 'public authorities' under the BMR to include third-country administrators of FX spot rates in non-convertible and pegged currencies. This would create a level playing field for such rates, given that these rates are generally the result of sovereign interventions which mean that local central banks should be deemed the de facto administrators – and as such the rates should be considered provided by 'public authorities' and as such outside the scope of the BMR.

The GFMA/ASIFMA notes that there are no alternative benchmarks for these non-convertible currencies, and that attempts to identify or create alternative rates would be an imperfect solution as it would create an unhedgeable risk and could lead to potential political consequences as third-country authorities respond to pressure on their domestic policies.

In addition to using NDFs and NDOs to hedge currency exposures, EU supervised entities will use non-deliverable interest rate swaps (NDIRS) to hedge their interest rate exposures to onshore risk. These products use the domestic interest rates to determine the coupon payments due in the non-deliverable currency which are then converted into to USD using the NDF rate. As a result, the GFMA/ASIFMA recommends that the treatment of administrators for restricted currencies as public authorities be applicable to all instruments referencing a spot rate not just FX forwards.

2) Non-significant benchmarks:

Given that non-significant benchmarks are unlikely to impact on the market integrity or stability of the EU or individual Member States, we recommend, on the basis of proportionality, to amend the BMR such that all non-significant benchmarks should not be required to gain authorisation via equivalence, recognition or endorsement and can continue to be used by EU supervised entities after the transition date.

In addition, the GFMA/ASIFMA recommends that all non-significant benchmarks should be provided with the opportunity to opt-in to being authorised in line with the regulation, similar to the regulatory regimes in Australia and New Zealand. Some administrators recognise that recognition through authorisation validates the integrity of their benchmarks required by investors, so where they have the means to seek authorisation they should be permitted to do so.

In the alternative, we recommend the amendment of the BMR as follows:

- that the use of non-significant third-country benchmarks be exempted from the scope of the BMR where they are used by institutional/professional counterparties within the EU. Where such benchmarks are used in transactions involving, or products sold to retail investors, those retail investors should be warned by means of disclosure of risks associated with non-significant third-country benchmarks which are not registered in the EU.
- that non-significant third-country benchmarks be able to obtain registration through a streamlined application process which would require administrators only to obtain (and provide to ESMA) independent third-party verification of the administrator's compliance with the IOSCO Principles on Financial Benchmarks; and/or
- that where third countries have received equivalence decisions from the EC in relation to legislative regimes which cover only domestically significant benchmarks (e.g. the Australian and Singapore regimes), there should be a rebuttable presumption that benchmarks in these jurisdictions which are not subject to such a regime shall not be subject to the BMR. We consider that this would be appropriate given that, if these benchmarks are not considered "significant" in their jurisdiction of origin, it is highly unlikely that they would be significant in the EU;

We consider the approaches outlined above to be appropriate on the basis that not only are non-significant benchmarks highly unlikely to pose a significant threat to the market integrity or financial stability of the EU, they are also the least likely category of third-country administrators to either apply for, or successfully receive, registration. We note that the third-country legislative regimes where equivalence has been granted, Australia and Singapore, are primarily focused on systemically important interest rate benchmarks rather than non-significant benchmarks. Likewise, Japan has only regulated its interest rate benchmarks, and we understand that the Korean and Indian regimes are similarly likely to focus on a very small number of benchmarks considered by their national regulators to be domestically significant. In New Zealand, the regulation has adopted an opt-in rather than a mandatory approach with the result that only the administrator of the primary domestic interest rate is expected to be licensed.

3) Grandfathering of Legacy Positions

We also recommend that, in order to prevent significant market disruption:

- EU supervised entities should be permitted to manage down their legacy positions using non-compliant third-country benchmarks for a period of 12 months, or longer provided the supervised entity is able to make a application for an extension on reasonable grounds to its NCA, after the end of the transition period; and
- EU supervised entities be allowed to use third-country benchmarks whose registration has been withdrawn or suspended for a period of 12 months, or longer provided the supervised entity is able to make a application for an extension on reasonable grounds to its NCA, following such withdrawal or suspension.

Similarly, we recommend permitting the use of new significant third-country benchmarks for a period of six months from the date of first use in the Union in order to allow administrators to obtain registration.

4) Benchmark/Index Published or made available to the Public

There is currently no differentiation in the BMR between a benchmark/index administered and published, often by a supervised entity on a proprietary basis, to a small number of counterparties that are professional clients of the supervised entity, and a benchmark/index that is published on a public forum or website on a commercial basis and is widely available for use by the general public.

Based on Recital 40 and the importance of proportionality and ensuring that an excessive administrative burden is not placed on administrators of benchmarks whose cessation poses less threat to the wider financial system, it is unreasonable to treat such ‘proprietary’ benchmarks/indices as those published on public forums or websites. As a result, the GFMA/ASIFMA recommends that ‘proprietary’ benchmarks/indices are excluded from the scope of BMR on the basis that regulating such benchmarks/indices does not provide any additional consumer protection.

5) Financial Instrument Scope

Article 3 (16) defines a 'financial instrument' as one that is traded on a trading venue (TOTV), submitted to be TOTV, or traded by a Systematic Internaliser (SI), as set out in the Markets in Financial Instruments Directive (MiFID II) Directive 2014/65/EU. This definition in the BMR results in a scope of financial instruments that is broader than those covered under the trading transparency requirements set out under MiFID II.

Not only does this inconsistency risk creating confusion on the part of the market, but it raises more fundamental public policy questions as to the purpose of the wider scope of the BMR vis-à-vis MiFID II.

Further, we note that the inclusion of instruments traded by an SI within the definition of 'financial instruments' requiring registration under the BMR is practically unworkable. This is on the basis that market participants lack visibility as to whether an SI might have traded a particular instrument that is not TOTV.

The GFMA/ASIFMA recommends that the scope of financial instrument in the BMR is aligned to the MiFID II pre-and-post trade transparency requirements for TOTV instruments. Therefore, the reference to SI's should be removed from the definition of 'financial instrument' contained within Article 3(16).

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The EU Benchmarks Regulation's third country regime

The EU Benchmark Regulation (BMR) bans the use of non-authorized benchmarks in new contracts from January 2020. BMR's third country regime allows for three routes that third country benchmark administrators can use to ensure compliance of their benchmarks in the EU: 1) equivalence (Art 30); 2) recognition (Art 32); and 3) endorsement (Art 33).

Unfortunately, all of these routes are characterised by significant shortcomings for third country administrators, which handicap their potential benefit and utility to allow third country benchmark administrators to comply with BMR prior to the end of the transition period on 1 January 2020. It seems highly unlikely that these shortcomings will be mitigated prior to the end of the transition period.

As such, EU users of these benchmarks are likely to face having to cease trading in contracts referencing these benchmarks, even though – typically - there are no alternatives available. It is also to be noted that whether third country benchmarks can be BMR compliant is not something that users have control over. Compliance is within the control of the administrators of the concerned benchmarks.

Below please find a summary of the problems associated with the three different routes through which third country benchmark administrators can ensure compliance with the BMR:

1. <u>Equivalence</u>

This option requires the third country jurisdiction to have binding requirements on benchmark administrators or specific benchmarks "equivalent" to BMR requirements. The equivalence option under the BMR requires a cooperation arrangement between ESMA and National Competent Authorities ('NCAs') of the third country, including exchange of information and coordinated supervisory activities. However, this option is unlikely to allow third country benchmark administrators to be authorised in the EU by the end of the transition period for the following reasons:

1. In most third country jurisdictions, there is no specific legal framework for benchmarks in place that is comparable to BMR, and as such, no basis for the EU to adopt an equivalence decision.
2. There are very few jurisdictions which already have regulations in place. The timing for the coming into force of regulations that other jurisdictions are drafting is uncertain. They may not become effective until after the end of the BMR transition period is due to finish.
3. If there is a comparable regulation in place in certain non-EU jurisdictions, it may not cover specific benchmarks such as FX, equity or commodity benchmarks.
4. In general, it seems highly unlikely that the European Commission has sufficient basis or time to adopt equivalence decisions to so many jurisdictions concerned within the next year, even if the European Commission has indicating willingness to accelerate the equivalence process. We understand that the European Commission is conducting assessments for certain priority jurisdictions, notably those that have in place a legal framework governing administration of benchmarks, e.g. New Zealand, Singapore, Canada, Korea and potentially Hong Kong (for FX rates).

5. The co-operation agreements that must be put in place in addition to an equivalence determination having been made may be difficult to achieve. They are required to include measures which may appear unappealingly extra-territorial to the third country jurisdictions such as the right for ESMA to access upon request all relevant information held by the third country competent authority on the administrator in question.

2. Recognition

The competent authority of the third country administrator's Member State of reference ('MSR') can grant recognition to a third country benchmark administrator subject to compliance with certain BMR requirements and the establishment of a legal representative in its Member State of reference that would be legally accountable for the provisions of the third country benchmarks on behalf of the third country benchmark administrator. This solution is not sufficiently operational to allow third country benchmark administrators to be recognised in the EU for the two following reasons:

1. Third country administrators seeking recognition which do not belong to a supervised EU affiliate are required to identify an EU member state of reference where the value of financial instruments, financial contracts or investment funds that reference the benchmark is the highest. However, the absence of publicly available data on trading volumes seriously hampers a third country benchmark administrator's ability to determine the member state of reference.
2. Once identified, the relevant National Competent Authorities will then assess the benchmark or family of benchmarks against the BMR rules and the IOSCO principles and decide whether to grant a recognition decision for the use of the benchmark or the family of benchmarks in the EU.
3. As of now, the role of the required legal representative remains unclear while the liabilities it is required to take on could be very significant – up to 10% of global annual turnover in some cases. Thus, EU supervised entities may be significantly disincentivized to act as a representative for third country benchmark administrators and/or require prohibitively high levels of compensation.
4. If the third country administrator is supervised in its home country, a cooperation agreement of the type referenced in relation to equivalence above is required (but between the competent authority of the member state of reference and the competent authority of the third country), with the same concerns over whether such an agreement would be possible in practice (Art 32.5(a)).
5. There is also a requirement that the effective exercise by the competent authority of its supervisory function is not prevented by the laws, regulations or administrative provisions of the third country (Art 32.5(b)). This may be a difficult requirement to satisfy.

3. Endorsement

An EU-authorized benchmark administrator can endorse a third-country benchmark under several strict conditions including an obligation to take an active role in the benchmark provision and to be able to ensure that the benchmark fulfils requirements at least as stringent as BMR requirements.

1. If an EU entity endorses a third country benchmark administrator, it will be liable for any infringements committed by the third country provider.

2. These potential liabilities can be very punitive i.e. up to 10% of global annual turnover.
3. Any company endorsing a third country benchmark administrator will thus demand a high degree of control and governance over the index administration of the third country benchmark administrator which they might be unwilling to cede.

All in all, as the Commission has publicly admitted (see relevant Politico article separately submitted), that two routes under the BMR third country regime- recognition and endorsement- are not working as the legislators had expected, while the third - equivalence – is likely to be insufficiently scalable and available. In light of this, equivalence determinations for all third country jurisdictions would not seem likely to be finalized before the end of the transition period and, as we have seen, are likely only to rectify the situation for certain benchmarks in each jurisdiction rather than that jurisdiction's benchmark population as a whole.

Example: India's spot FX benchmark provided by FBIL

Rationale for using the benchmark:

This benchmark is a daily reference rate linked to the foreign exchange rate of the Indian rupee (INR) against other currencies- currently the Euro, US Dollar, Pound and Yen.

Whenever a European company engages in India, it has to use Indian rupees (for paying employers, investing in machinery or selling a product). However, as a European company it will ultimately need to convert their costs and revenues into euros. Consequently, they are exposed to fluctuations in the exchange rate of euros to rupees (currency risk). A company can use the Indian FX spot benchmark to hedge or off-set this risk by investing in a financial product which correlates with the currency risk, i.e. it allows the company to pre-agree the exchange rate it will receive for future transactions. For example, when the Indian rupee loses its values, the pay-off of the financial product referencing the rupee exchange rate will offset detriment otherwise associated with the relative change in the value of the rupee. The use of the FBIL FX spot benchmarks allows companies to manage the currency risk with respect to Indian rupee.

Hypothetical example for uncertain revenues: Company C sells a car worth 100.000€

- In January 2018, an Indian car seller agreed to buy a car from the European 'Company C' for 8.000.000 rupees, equivalent to 100.000€ (i.e. an exchange rate of 80:1). The payment would take place when the Indian car seller sold the car.
- In February, the car is sold and the Indian seller transferred 8.000.000 rupees to Company C.
- In the month between agreement and formal sale, the rupee/euro exchange rate changed to 100:1. In euro terms, Company C earned 80.000€ from the car sale, i.e. 20.000€ less than originally intended.
- However, Company C uses derivatives, in this case most likely options or futures, whose pay-offs correlate with the devaluation of the Indian rupee. Ideally the profits from the use of derivatives referencing the exchange rate of the Indian rupee are close to 20.000€. In other words, the use of FBIL's FX benchmark eliminates the currency risk, known as hedging, and Company C does not face uncertainty on their returns.

One may note that in reality, Indian car sellers and European car manufacturers do not engage in contracts on a car by car basis but instead agree wholesale contracts, based on total expected sales for the period in question, i.e. a contract would consider hundreds or thousands of cars. Therefore, a contract is likely to be on a scale of millions of euros.

Hypothetical example for uncertain costs: Company C pays salaries for Indian employees

- European Company C has a fixed monthly salary bill of 1.000.000 Rupees for its Indian employees, which must be paid in Rupees. If it does not hedge the risk of each monthly payment, it will be vulnerable to fluctuations in the Euro-Rupee exchange rate, meaning that each fixed salary bill in Rupees will vary in Euros. This uncertainty means that Company C would have to set aside a greater amount of Euros each month in case this is required, leaving less money for investments elsewhere.
- However, Company C is able to hedge this risk by entering into a deal with European 'Bank B'. The parties agree upfront which Rupee-Euro exchange rate Bank B will give Company C for its fixed salary bill each month. For example, in month two, the exchange rate might be agreed as 1.000.000 Rupees for 12.500 Euros, i.e. a rate of 80:1.
- Currencies such as Rupees are subject to local controls, which means that they can only be traded onshore in India. Therefore, instead of the European Bank and Corporate actually exchanging Euros and Rupees each month, they exchange the difference between the values of the two amounts. This will then allow Corporate C to make the exchange onshore in India and pay its salary bill.
- Imagine the exchange rate in month 2 has moved and is now 66,66:1. Without hedging its risk, 1,000,000 Rupees would have cost Company C 15,000 Euros. However, its contract with Bank B means that Bank B will pay Company C the difference between the agreed and actual rates (3,000 Euros) and Corporate C will now have enough money to meet its monthly salary bill at the expected price.

One may imagine similar examples regarding investments in productions plants, service provider contracts and other activities in the Indian market. Every European company which conducts business in other currency areas faces risks originating from fluctuations of exchange rates and will thus use appropriate spot FX benchmarks to eliminate these risks.

Will FBIL's FX spot benchmark be compliant for use in the EU under the BMR?

The Reserve Bank of India announced its intention to publish a draft regulatory framework for financial benchmarks which would cover the FBIL FX benchmark. If this regulation is effective in time, it may be that the European Commission could make an equivalence decision. However:

- Considering the legislative timetable that the regulations must pass through, it is not certain that the process will be finalized by the end of the BMR transition period. If, in particular, any legislative amendments are required, the timeline is likely to stretch long beyond that point. It is concerning that the draft regulations have yet to be produced and are overdue.
- Even if the regulations are passed and an equivalence determination is made, it is not clear that the Indian authorities would agree to the terms of a cooperation agreement that required them to disclose information regarding FBIL to ESMA on request. They may well see these rates as important to their sovereignty.
- As discussed above, recognition and endorsement have significant impediments associated with them. We are not aware of any intention on the part of FBIL to set up a European entity for these purposes and the lack of volume data in relation to the benchmarks' use in the Union will

make identification of their member state of reference very difficult. Consequently, this very important Indian FX spot benchmark may not be available for use by European Union manufacturers or investors post 1 January 2020.

Consequences of non-compliance of the Indian FX benchmark in the European Union

In case where this FBIL FX spot benchmark can no longer be used in the EU post January 2020, European companies will be left with two poor alternatives:

1. They will be unable to hedge their Indian rupee currency risks. In our example above, Company C will be faced with serious uncertainty relating to their actual investment costs and returns due to the absence of the described risk-management tool, and risk of losses associated with rupee/euro currency fluctuations to the extent it continues to operate in India. Competitors from other jurisdictions, meanwhile will be able to hedge currency risk in India without any such obstacle.

2. They may still agree on a bilateral basis for each hedging transaction (e.g. FX forwards) a rupee fixing reference. Such a fixing would be non-auditable and less efficient than the current globally recognised benchmark.

Unfortunately, the Indian rupee FX benchmark is not the only third country benchmark facing non-compliance by the end of the BMR transition period. Similar concerns apply in respect of jurisdictions such as South Korea, Hong Kong, Taiwan or the Philippines.

Conclusion

We are deeply concerned that very few third country administrators will successfully obtain registration and authorisation for use of their benchmarks in the EU after 1 January 2020. In such an event, markets globally, including the European Union and its important markets across the APAC region are likely to suffer a significant impact. This impact includes reducing the number of benchmarks in the region and denying EU firms, and potentially some of their affiliates, access to financial instruments and contracts that reference third country benchmarks, including derivatives, loans, bonds and mortgages. A de-facto prohibition of many third country benchmarks, due to their administrator's inability to seek compliance under the BMR third country regime, could lead to severe market disruptions in financial markets and put European companies from the real economy at significant competitive disadvantages.