Consultation Response

EC Call for Evidence on the review of the scope and third-country regime of the EU Benchmarks Regulation

29 March 2023

The International Swaps and Derivatives Association (ISDA), the European Association of Corporate Treasurers (EACT), the Trade Association for the Emerging Markets (EMTA), the Futures Industry Association (FIA) and the Global Financial Markets Association (GFMA) ("The Associations") welcome the opportunity to respond to the European Commission's Call for Evidence ("**CfE**") on the 'Review of the scope and third-country regime of the Benchmark Regulation.'

Introduction

The Associations strongly support the EC's statements in the CfE acknowledging that:

- the scope of the EU Benchmark Regulation ("BMR") is much broader than regulations passed in other major jurisdictions.
- very few non-EU administrators have so far spent the time and resources necessary to obtain access to the EU market and that there may not be sufficient economic incentives to do so.
- by prohibiting use of non-compliant third-country benchmarks by default in the EU, BMR would deprive EU market participants access to benchmarks they need in order to measure markets, hedge risks and create investment exposure.
- many benchmarks are locally anchored meaning that they cannot easily be replaced by an EU benchmark that measures the same market or economic reality.
- the main principles of the BMR are not being called into question but, as drafted, unintended consequences would put EU users at a significant competitive disadvantage to their non-EU peers.
- non-EU administrators using the EU Paris-aligned Benchmarks (EU PAB) or EU Climate Transition Benchmarks (EU CTB) labels would be subject to EU supervision of all label-related BMR provisions.

Reforms of the type contemplated in the CfE represent a vital opportunity to rebalance BMR so that it provides protection to investors on a proportionate basis, in alignment with global standards; imposing the highest compliance burdens in respect of the most systemically important benchmarks and ensuring EU investors have better visibility of the benchmarks they are permitted to use, and those whose use is prohibited.

We believe there are other vital reforms not expressly contemplated in the CfE, which are critical to ensure end-users do not face cliff-edge risks in respect of benchmarks they use which then, for any reason, become prohibited. For ease of reference, a table attached as Annex 1 summarizes the reforms that the Associations support. Further details are provided in 'The Importance of Reforming the EU Benchmarks Regulation'[1] (the 'Briefing Paper') which ISDA co-published with GFMA, FIA, ASIFMA, EACT and EMTA in August 2022.

It is also very important that the transition period for the third-country regime is extended by means of the recently announced Delegated Act[2] as soon as possible. Any delay or uncertainty may have profound effects on investor behaviour that may be to their detriment and disruptive to the market.

Type of Designatory Regime

Positive Designation: The Associations strongly support the proposal that only systemically important EU and Third Country benchmarks that have been positively designated by the European Commission should be in scope of BMR for mandatory compliance. This approach ensures the highest level of certainty and visibility for users and administrators of benchmarks.

Problems with Negative Designation: The Associations strongly oppose the alternative approach of negative designation, which would see BMR's broad scope maintained but made subject to a power that would enable the EC to designate individual benchmarks as out of scope upon request.

This regime would perpetuate nearly all of the problems with the current regime:

- There are an estimated 3 million benchmarks in existence worldwide[3]. Most of them pose no systemic or material risk to users in the EU. Over time, the number of exempted benchmarks would therefore become very large, imposing significant bureaucratic burdens on the EC, end users and administrators.
- End users, in particular, would be obliged to search through large numbers of records to establish whether an exemption existed for the benchmark they wished to use. The current ESMA register would not provide them with sufficient visibility and would need a significant overhaul. In the meantime, users would continue to be subject to the risk that benchmarks they use become prohibited, particularly at the end of the transition period for

[1] https://www.isda.org/a/YM2gE/The-Importance-of-Reforming-the-EU-Benchmarks-Regulation.pdf

[2] https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13624-Suspension-of-rules-on-non-EU-benchmarks-extension-to-end-2025_en

[3] http://www.indexindustry.org/2019/10/15/index-industry-associations-third-annual-survey-finds-2-96-million-indexes-globally/

third country benchmarks. As described in detail in the Briefing Paper[4], prohibition of a benchmark is just as disruptive to users as its cessation, potentially leaving them unable to make payments, value positions, terminate or transfer their exposures in respect of live transactions.

The February 2021 amending Regulation[5] that introduced a negative designation power in relation to certain foreign exchange benchmarks also goes to illustrate the difficulty of drafting such a power with sufficient precision and flexibility. While the power has yet to be exercised, there remains uncertainty among market participants as to whether it is sufficiently broadly drafted to encompass all of the foreign exchange benchmarks whose potential prohibition gave rise to the power in the first place.

Designation Criteria

The criteria that must be satisfied in order to make a positive designation are critical.

The EC's September 2022 Consultation[6] set out a list of nine potential criteria that it asked for feedback on. The related Summary of Responses[7] showed divergent views on which of them should be used. This divergence is likely to be attributable to the fact that:

- none of them, either individually or in combination, are definitively capable of determining whether a benchmark is sufficiently important to warrant designation.
- some of the suggested criteria were not relevant – there would be little point in designating a benchmark, for example, if it were widely used globally, but not in the EU. If the benchmark is for a particular use (providing a borrowing rate, for example) but not widely used, again, it would not seem proportionate to designate it.
- other criteria were open to misinterpretation. As the CfE highlights, many benchmarks are locally anchored meaning that, even where they may appear on the surface to measure similar economic realities, they may, in fact, be determined using completely different methodologies. This means that they are not, in practice, substitutable for each other. We understand that this is more often the case than not.

It was for these reasons, that the Briefing Paper suggested instead using two qualitative tests and only using other criteria (including a quantitative threshold) as guidance for the EC in determining whether those two tests had been met. These tests and guidance criteria are discussed in more detail below.

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[4] Ibid

[5] Regulation (EU)) 2021/168 of the European Parliament and of the Council of 10 February 2021 amending Regulation (EU) 2016/1011 as regards the exemption off certain third-country spot foreign exchange benchmarks and the designation of replacements for certain benchmarks in cessation, and amending Regulation (EU) No 648/2012.

[6] https://finance.ec.europa.eu/system/files/2022-05/2022-benchmarks-third-country-consultation-document_en.pdf

[7] https://finance.ec.europa.eu/system/files/2023-01/2022-benchmarks-third-country-summary-of-responses_en.pdf

Positive designation power criteria

Benchmarks should only be capable of being positively designated following an evidence-based determination (including a public consultation and discussion with the relevant administrator) that all of the following conditions are met:

1. **The Impact Condition.** Cessation of the benchmark or it becoming non-representative would result in significantly adverse impacts on market integrity, financial stability, consumers, the real economy, or the financing of households and businesses in one or more Member States[8]; and
2. **The Proportionality and Public Interest Condition.** Designating the benchmark is proportionate and in the public interest.

The EC should consider the following non-exclusive and non-conclusive factors as guidance in determining whether these criteria have been satisfied:

(i) Notional amount/values of assets in the EU referencing the benchmark exceeds €500 billion.

(ii) For the purposes of determining whether designation is proportionate and in the public interest account should be taken of:

a. whether the administrator/benchmark is already subject to regulatory supervision in its domestic jurisdiction and/or complies with the IOSCO principles.

b. Whether designation of the benchmark might directly result in use of the benchmark by Supervised Entities becoming prohibited, particularly in circumstances in which there are no, or very few, appropriate market-led substitutes.

Regulated data benchmarks have already been removed from the scope of BMR and should remain out of scope of mandatory designation. Where the input data is regulated at its source, then it is appropriate to reduce the regulatory burdens applicable to these benchmarks under the BMR. The regulated data benchmark exemption should extend to include indices that rely on inputs from major global exchanges.

Public utility benchmarks – for example, FX rates used in NDFs and interest rates (including restricted or pegged rates) used in dollar-settled swaps (e.g., NIRDS) – should not be in scope of mandatory designation because they are pseudo-governmental and their prohibition would be disproportionately disadvantageous to end users.

[8] This wording mirrors Article 20(1)(c) of BMR for determining a Critical Benchmark.

ESG labelled benchmarks should not be treated differently from other categories and the fact that they are ESG labelled should not, on its own, be the basis for designation.

Parity of scope between EU and non-EU benchmark administrators and inclusion of a voluntary regime

As already discussed above, the designation regime should apply equally to EU and non-EU benchmarks.

Administrators of benchmarks that would otherwise be out-of-scope should be able to elect for their benchmarks to comply and be labelled as such.

- It would provide an opportunity for EU and third-country administrators to gain recognition of the efforts and investment that they have already made to comply with the BMR.
- It would incentivize non-EU administrators to comply with higher standards by enabling them to use the labelling in their marketing.
- It would provide investors with confidence that benchmarks they use that carry this label meet those high standards.

The Australian[9] and New Zealand[10] benchmark regulations both contain an elective regime of this nature.

Creation of an EU ESG Benchmark Label

With respect to the options set out in the EC's study on the feasibility of an EU ESG benchmark label, which identifies and analyses possible approaches for the creation of minimum standards for an EU ESG Benchmark, our preferred option would be to have a voluntary label using minimum standards. For the avoidance of doubt, we believe that the ability of administrators to use the ESG label should not be contingent on those benchmarks complying with the rest of BMR but only on whether they comply with those minimum label-related standards.

We believe that mandatory minimum requirements for ESG benchmarks would impair the ability of users to choose a benchmark suited to their particular needs (including a focus solely on a specific E, S, or G factor in their product). The creation of a mandatory ESG benchmark label through legislation could stifle development of this nascent market, undermine innovation, impede administrator's methodological freedom to create a variety of ESG benchmarks and create additional administrative requirements and costs for benchmark administrators likely to be passed on to investors. The Associations believe it should be left to the discretion of market participants to decide whether to opt-in to a voluntary EU ESG benchmark label and that it should not be very granular but

[9] https://www.legislation.gov.au/Details/C2018A00027. In Australia, administrators of significant benchmarks must be licensed under the Corporations Act 2001 as opposed to administrators of non-significant benchmarks, which may voluntarily "opt-in" to that licensing scheme.

[10] http://www.legislation.govt.nz/act/public/2013/0069/latest/whole.html. In New Zealand, under legislation that received Royal assent on 30 August 2019, licensing is not required for any benchmark administrators. However, administrators may "opt-in" to obtain licensing under the benchmark administrator licensing scheme.

based on broad principles of sustainability to allow maximum flexibility and consider best-in-class and exclusion strategies.

Regulation 2019/2089 allows benchmark administrators to have a certain degree of flexibility when designing benchmark methodologies. This is because certain elements of ESG may be objectively measured (greenhouse gases) whereas other matters are highly subjective (social convictions). These are key provisions aimed at ensuring continued innovation and supporting the uptake of the wider ESG index market. ESG benchmarks can include a broad variety of ESG factors or just one single factor. ESG benchmarks may reference a wide variety of underlying asset classes, such as equities, bonds, real estate investments, sovereign bonds, even municipal bonds. Some indices will also specifically be constructed per the request of a client and as per its own ESG objectives or criteria. This diversity and innovation is of a great value to the sustainable finance ecosystem to ensure all clients can be served and the various ESG objectives of each stakeholder are met.

Furthermore, if the European Commission does proceed with a voluntary ESG benchmark label, we would urge it to ensure the standards are clear and achievable. We do not agree that there should be an ESG label before the development of minimum requirements for Article 8 and Article 9 products under the Sustainable Financial Disclosure Regulation (SFDR). A different sequencing could create legal uncertainty and conflict if the establishment of an ESG benchmark label precedes and ultimately does not align with the minimum requirements for Art. 8 and 9 SFDR products currently under review.

We would therefore recommend a coordinated and sequenced approach whereby those concepts are clarified in the context of their original regulation (SFDR or Taxonomy Regulation) before being implemented in other legislative texts. We understand this approach would also align with ESMA's recommendation, given the significant overlaps in the current sustainable finance regulatory framework due to a lack of coordinated approach.[11]

Critical Additional Reforms
In addition to the proposals contemplated in the CfE, there are other reforms which the EC should propose to BMR in order to protect end users from unintended consequences:

- **No New Flow**
    - If the administrator of a designated benchmark fails to gain qualification within a fixed period of time, or to maintain qualification thereafter, it would become a 'non-qualifying benchmark' and therefore prohibited, save as set out below.
    - A designated benchmark which becomes non-compliant should continue to be permitted to be used in legacy transactions (without contingency), including where a legacy contract subsequently falls back to such benchmark as the result of existing fallback provisions becoming applicable.

[11] https://www.esma.europa.eu/sites/default/files/library/esma81-393-502_esma_response_to_the_ec_consultation_on_the_bmr_review_2022.pdf, p13

- Use in new transactions should be automatically permitted for the following purposes:
  a. reducing/hedging/novating the legacy exposure of any client.
  b. determining a close out amount.
  c. market-making in support of client activity related to legacy transactions.
  d. reducing/hedging/novating/managing a Supervised Entity's exposure whensoever that exposure was incurred.
  e. participation in a central counterparty procedure.
- These provisions should cover all scenarios in which a designated benchmark could become prohibited:
  - Withdrawal/suspension of registration/authorization/equivalence/recognition/endorsement;
  - Failure to comply at expiry of the transition period;
  - Prohibition on use of a benchmark for any other reason.
- These provisions should not be subject to any contingencies (such as the need to demonstrate frustration, force majeure or breach) or require any regulatory authority to exercise any power in order for users of the non-qualifying benchmark to benefit from them.
- This approach provides users of benchmarks that fail to become compliant or become non-compliant with the ability to manage or reduce their exposures in a safe and efficient way, avoiding the current risk of a cliff edge. This will align BMR with the global regulatory approach taken to prohibition on use of LIBOR[12], [13], [14].

- **Improving End-user Visibility**
  - In order to avoid the confusion and market disruption that can result from any uncertainty, it is vital to provide users with a golden source of compliant benchmarks including the following:
    - Full name/unique benchmark level identifier (including ISIN) of every EU and 3rd country compliant benchmark.
    - Name/jurisdiction of the administrating entity (not group)
    - Whether designated for mandatory compliance.

[12] https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20201130a1.pdf

[13] https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20201130a1.pdf

[14] https://www.fca.org.uk/publication/libor-notices/article-21a-benchmarks-regulation-prohibition-notice.pdf

- Status of applications (pending/approved/rejected) for authorisation/registration/ recognition/endorsement with relevant dates or whether a benchmark qualifies under an equivalence determination.
- Suspension/withdrawal/reinstatement of authorisation/registration/equivalence/recognition/endorsement and the date such notice was issued.
- Other status flags to the extent that additional powers are exercised in relation to administrators or their benchmarks.
- Additional fields to help users keep track of changes to each administrator (e.g authorisation date/last update).
- Links to the website pages of the administrator that deal with EU BMR-specific information, including links to the benchmark statements pursuant to Article 27.

▪ The register should allow for filtering of benchmarks by category (e.g designated/voluntary benchmarks).

▪ The register should be machine searchable.

▪ There should be a notification e-mail service which alerts subscribers to updates and new information added to the register.

▪ It is important that the register remains capable of being updated in real time in order to avoid any delay between a benchmark becoming compliant and its being able to be used by investors. This could be achieved by making administrators of non-designated benchmarks responsible for uploading and maintaining the information relating to voluntarily compliant benchmarks on a continuous basis. while ESMA retains responsibility for uploading and maintaining the information relating to designated Benchmarks on a continuous basis.

- **Penalties for Breach**

▪ Currently BMR imposes penalties of up to 10% of annual global turnover for a wide range of breaches (including administrative breaches). Given that BMR does not deal with manipulation-type offences, the penalty regime should be reformed to be more proportionate to the nature of the breach.

Annex 1 - High level comparison of the reforms proposed within this response against the existing provisions of the European Benchmark Regulation.

Characteristics	Existing BMR	Reformed BMR
Use of benchmarks	Prohibited unless specifically qualified	Permitted unless specifically prohibited
Scope	All benchmarks regardless of size or systemic importance with very limited exemptions	**Designated Benchmarks**. Only EU and Third Country benchmarks positively designated by the European Commission would be in scope for mandatory compliance. **Voluntary Regime.** All other EU and Third Country Benchmarks would be removed from scope for mandatory compliance but able to comply via a voluntary regime. **Designation Power.** EU and third country benchmarks which are systemically important in the EU would be subject to mandatory compliance if positively designated by the European Commission following an evidence-based determination (based upon a public consultation and discussion with the relevant administrator). The EC's designatory power would be exercisable provided all of the following conditions are met: • **Cessation/non-representativeness of the benchmark would result in significant/adverse impacts** on market integrity, financial stability, consumers, the real economy, or the financing of households and businesses in one or more Member States[15]; and • **Designating the benchmark is proportionate and in the public interest**. The EC should consider the following non-exclusive and non-determinative factors in determining whether these criteria have been satisfied: (iii) Notional amount/values of assets in the EU referencing the benchmark exceeds €500 billion.

[15] This wording mirrors Article 20(1)(c) of BMR for determining a Critical Benchmark.

		(iv) For the purposes of determining whether designation is proportionate and in the public interest: a. Whether the administrator/benchmark is already subject to regulatory supervision in its domestic jurisdiction and/or complies with the IOSCO principles. b. Whether designation of the benchmark might directly result in use of the benchmark by Supervised Entities becoming prohibited, particularly in circumstances in which there are no or very few appropriate market-led substitutes. All other EU and third country benchmarks would be removed from scope for mandatory compliance but able to comply via a voluntary regime. The fact that a benchmark is labelled as an ESG Benchmark should not, on its own, make it subject to designation for mandatory compliance.
Means of qualification	**EU** • Authorization • Registration **Third country** • Equivalence • Endorsement • Recognition	**EU and Third Country** • Authorization • Registration • Equivalence • reformed Endorsement • reformed Recognition
Powers to prohibit use of	**EU Benchmarks**	**EU and Third Country**

non-qualifying benchmarks and powers to allow continued use for legacy	• Powers to allow continued use of EU Benchmarks in legacy contracts provided that poorly defined contingencies are met (frustration, force majeure, breach)
	• Powers for EU benchmarks do not encompass all circumstances in which a benchmark may become prohibited
	• Inability to use non-qualifying benchmarks in <u>new</u> transactions to manage legacy risk creates cliff-edge risks for EU investors
	Third Country Benchmarks
	• Legacy contracts permitted to continue to use non-qualifying benchmarks until maturity.
	• Inability to use non-qualifying benchmarks in new transactions to manage legacy risk creates cliff-edge risks for EU investors
		In line with 'tough legacy' approaches for LIBOR, use of non-compliant EU and Third Country designated benchmarks prohibited except:
		• use permitted in legacy contracts (including where a legacy contract subsequently falls back to such benchmark as the result of existing fallback provisions becoming applicable).
		• new transactions automatically permitted for the following purposes:
		    ○ reducing/hedging/novating the legacy exposure of any client.
		    ○ determining a close out amount.
		    ○ market-making in support of client activity related to legacy transactions
		    ○ reducing/hedging/novating/managing a Supervised Entity's exposure whensoever that exposure was incurred.
		    ○ participation in a central counterparty procedure.
		These provisions should cover all relevant circumstances including:
		• Withdrawal or suspension of Registration, Authorization, Equivalence, Recognition or Endorsement
		• Failure to comply at expiry of any transition period
		• Prohibition on use of a benchmark for any other reason.

End user visibility of application process for qualifying benchmarks	Very limited data on ESMA's register, insufficient to allow end users to understand whether the benchmark they want to use qualifies or has become prohibited	Enhanced visibility for end users with more comprehensive data on ESMA's register

Penalties for breach	Up to 10% of global annual turnover for even relatively administrative breaches.	The highest penalty reserved for only the most serious breaches.

About EACT

Representing the European economy, the EACT brings together 14 000 corporate treasury professionals active in 22 countries and working for around 6 500 individual non-financial companies. Corporate treasurers are the finance professionals of the real economy.

About EMTA

Founded in 1990, and currently with over 170 members worldwide, EMTA (formerly, the Emerging Markets Traders Association) is a not-for-profit corporation dedicated to promoting the orderly development of fair, efficient and transparent trading markets for Emerging Markets instruments, and the integration of the Emerging Markets into the global financial marketplace. EMTA's website is located at www.emta.org.

About FIA

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from about 50 countries as well as technology vendors, law firms and other professional service providers.

FIA's mission is to:

- support open, transparent and competitive markets,
- protect and enhance the integrity of the financial system, and
- promote high standards of professional conduct.

As the principal members of derivatives clearinghouses worldwide, FIA's clearing firm members play a critical role in the reduction of systemic risk in global financial markets.

About GFMA

Global Foreign Exchange Division of the Global Financial Markets Association (GFMA) was formed in co-operation with the Association for Financial Markets in Europe (AFME), the Securities Industry and Financial Markets Association (SIFMA) and the Asia Securities Industry and Financial Markets Association (ASIFMA). Its members comprise 25 global foreign exchange (FX) market participants[1], collectively representing the majority of the FX inter-dealer market[2]. 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.

[1] Bank of America, Bank of New York Mellon, Barclays, BNP Paribas, Citi, Credit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, ING, JP Morgan, Lloyds, Mizuho, Morgan Stanley, MUFG Bank, NatWest Markets, Nomura, Northern Trust, RBC, Standard Chartered Bank, State Street, UBS, US Bank and Wells Fargo.

[2] According to Euromoney League Tables

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 79 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.