



## **EMMI Response to ESMA Consultation Paper**

### *Draft technical advice under the Benchmarks Regulation*

30 June 2016



## A. Introduction

The European Money Markets Institute (“EMMI”) welcomes the opportunity to provide comments on ESMA’s Consultation Paper on draft technical advice under the Benchmarks Regulation.

EMMI provides the following two indexes: Euribor<sup>®</sup>, the money market reference rate for the euro; and Eonia<sup>®</sup>, the effective overnight reference rate for the euro.

As an administrator of critical benchmarks, EMMI supports the objectives of the BMR to improve the governance and control over the benchmark process, thereby ensuring its reliability and protecting users and the broad financial market.

Our response to ESMA’s Discussion Paper on the Benchmark Regulation is aimed at providing the perspective of an administrator of critical benchmark(s) with respect to certain questions set out in this consultation paper. EMMI believes that a proportional approach with regard to the different types and categories of benchmarks is appropriate. Our response should be read taking into account both EMMI’s perspective as an administrator of critical benchmarks as well as our support for a proportional approach.

## B. Responses to consultation questions

*Q1: Do you agree with the conditions on the basis of which an index may be considered as made available to the public?*

EMMI agrees that an index should be deemed “to be made available to the public” in the meaning of Article 3 when the index is accessible by a large or potentially indeterminate number of recipients. In EMMI’s view, an index may be accessed through a variety of media and modalities, set out by the administrator or agreed between the administrator and the users. This approach enables administrators to adapt its distribution channels as the needs of the users evolve.

*Q2: Do you agree with the proposed specifications of what constitutes administering the arrangements for determining a benchmark?*

EMMI considers that the new proposed specification does not cover all the core aspects of the administrator’s responsibilities, in particular with regard to the governance arrangements, including oversight and accountability.

While EMMI acknowledges ESMA’s efforts to distinguish the definitions of ‘provision of a benchmark’ and for ‘administrator’ as foreseen in the BMR, the proposal to specify what constitutes administering the arrangements for determining a benchmark – which contains the element of ‘administering’ – to the ongoing management of the infrastructure and the personnel and the setting of a specific methodology is, in EMMI’s view, too restrictive and focused on an operational approach.

The establishment of governance arrangements (i.e. governance, oversight and accountability procedures) is one of the key elements of a benchmark determination process – and therefore, the administrator’s responsibilities (outsourced or not) – that is to a very large extent recognized in the IOSCO Principles and in the BMR. Therefore, EMMI recommends to come back to ESMA’s proposal in the Discussion Paper on the Benchmarks Regulation of 15 February 2016 to align the administering the arrangements for determining a benchmark with IOSCO Principles 1 on the overall responsibility of the administrator.

*Q3: Do you agree that the ‘use of a benchmark’ in derivatives that are traded on trading venues and/or systematic internalisers is linked to the determination of the amount payable under the said derivatives for any relevant purpose (trading, clearing, margining, ...)?*

EMMI welcomes the clarification linking the use of a benchmark in the process of engineering the terms of a financial derivatives contract with the determination of the amounts payable under the said instrument.

*Q5: What are your views on the transitional regime proposed to assess the nominal amount of financial instruments other than derivatives, the notional amount of derivatives and the net asset value of investment funds when regulatory data is not available or sufficient?*

During the transitional period, the absence of data streams based on MIFIR and EMIR will leave no alternative except for using proxies in order to estimate the reference value of benchmarks. However, the proposed draft does not clearly attribute the responsibility in this exercise.

EMMI favors the use of proxies as the ones mentioned in the discussion: e.g. the existence of a significant market of futures and options traded on trading venues. These indicators can be retrieved by the administrators from selected clients or by the regulators from supervised entities. Similarly, data from alternative private providers could be used. Therefore, *ad hoc* methodologies should be considered based on the existing data for each benchmark in close cooperation between regulators and administrators.

*Q6: Do you agree with the measurement performed at a specific point in time for assessing whether a benchmark hits the thresholds specified in Article 20(1) to be considered as critical?*

EMMI agrees that the use of critical benchmarks should be very stable over time; however, calendar effects could trigger periodic peaks in certain markets. Therefore, if seasonality is observed, guidance on the choice of the specific point in time for assessing the reference value may be necessary.

*Q7: What are your views on the use of licensing agreements to identify financial instruments referencing benchmarks? Would this approach be useful in particular in the case of investment funds?*

The distribution models established by administrators might not be adapted to target specific types of users according to types of financial instruments. As an example, at EMMI, the standard subscription agreement identifies the users that need access to the data within the first 24h of publication. Therefore, there is no systematic identification of the users that retrieve data 24h after publication. Furthermore, licensing agreements do not identify the financial instruments referencing the benchmark.

If EMMI was requested to gather information from users on the financial instruments referencing the benchmark, it would require significant upgrades in order to deal with legal requirements in the field of data privacy, IT systems and security, data collection and analysis.

Taking into account the specificities of investments funds, licensing agreements could not be used a proxy to assess the net asset value of the funds.

*Q11: Do you agree with the criteria, included in the draft technical advice, that NCAs should use when assessing whether the transitional provisions could apply to a non-compliant benchmark? Could you suggest additional criteria?*

EMMI understands that ESMA's draft advice clarifies that Article 51 should not be seen as a provision that will provide an effective form of grandfathering other than in exceptional circumstances. EMMI fully agrees with this general approach.

EMMI agrees with most of the criteria included in the draft technical advice, but it has comments on the following three criteria set out in point 2 of the Draft Technical Advice on transitional provisions:

1. In cases where changing a benchmark to conform with obligations of the Benchmarks Regulation would lead to a material change to the input data, to the methodology, to the data gathering process or to other elements of the benchmark provision, the competent authority should consider whether this change would lead to a significantly different value of the benchmark.
2. Whether there exists a substitute benchmark for the non-compliant benchmark that measures the same market or economic reality of the non-compliant benchmark and is compliant with the Benchmark Regulation (i.e. it is included under the Register of administrators and benchmarks envisaged in Article 36 of the Benchmarks Regulation or is provided by an administrator listed therein).
3. Whether the existing financial contracts, financial instruments and investment funds (or their accompanying documents) referencing the non-compliant benchmark already include a reference to a possible substitute benchmark and, if yes, how such substitute benchmark has to be determined.

EMMI understands that the criteria set out in the Draft Technical Advice on transitional provisions will also apply to the references to article 51 in article 35.3 and 46.8 of the Benchmarks Regulation. In other words, that those criteria will also apply in situations where the authorisation or registration of an administrator is withdrawn. EMMI fully agrees with this approach.

**The first criterion**

The first criterion is whether the changes required by the Benchmarks Regulation will lead to a significantly different value of the benchmark. EMMI agrees that changes in the rate and the volatility of the benchmark are relevant to determine whether force majeure events, contract frustration or other breaches of the terms of any financial contract or financial instrument may occur if the non-compliant benchmark undergoes changes to bring it in line with the Benchmarks Regulation. The concern is that the term “*significantly different value*” is rather vague, which may create uncertainty as to its interpretation. Therefore, further guidance as to how the term “*significantly different value*” should be interpreted would be welcome.

The Markets Participants Group report on Reforming Interest Rate Benchmarks of March 2014 (“MPG Report”) discussed this criterion as well. The MPG Report acknowledges that material variations in the rate or volatility could jeopardise contractual continuity but also states that “*Moreover, even if there is a material difference, in some situations a case could be made that the proposed rate is actually more representative of the intended legal definition of the benchmark than that provided by the legacy fixing*” (MPG Report, p. 42). It cannot be excluded that the benchmark (after undergoing the changes required by the Benchmarks Regulation) would actually be a more accurate measurement of the economic reality the benchmark is intended to measure. In such cases, the risk of force majeure events, contract frustration or other breaches of the terms of any financial contract or financial instrument would be significantly lower even if there would be a significantly different rate or volatility.

#### **The second and third criteria**

Both the second and the third criteria relate to the concept of contract continuity, i.e. if the non-compliant benchmark would no longer be provided, would the agreements that reference the non-compliant benchmark still continue by referring to a substitute benchmark. The second criterion is whether substitute benchmark(s) exists. The third criterion is whether users of the non-compliant benchmark have foreseen fall-back clauses.

EMMI agrees that the question whether the non-compliant benchmark could be substituted by another compliant benchmark is relevant to decide whether the transitional provisions should apply to a non-compliant benchmark. EMMI thinks however that the aforementioned criteria do not fully reflect that relevant question. EMMI believes that the second criterion is not in itself useful to answer the question of substitutability and that this criterion is already implicitly but certainly included in the third criterion. Therefore the second criterion does not need to be a separate criterion. In EMMI’s view, the third criterion is the relevant criterion but it should be broadened to include all contractual provisions that relate to contract continuity (and not only the fall-back provisions).

#### The second criterion is not in itself useful and is already included in the third criterion

Even if substitute benchmark(s) are available, force majeure events, contract frustration or other breaches of any financial contract or financial instrument which references the non-compliant benchmark may still occur if the non-compliant benchmark would be changed. This is of course subject to a full legal analysis of all relevant circumstances.

It is clear from the MPG Report that, even if substitute benchmarks are available, the transition towards such successor benchmarks may still cause legal uncertainty including force majeure events, contract frustration or contractual breaches. The MPG Report analysed different transition paths for interest rate benchmarks, including a transition towards a successor benchmark (called “Successor Rate Transition”). The MPG Report concluded that in the absence of fall-back clauses, a Successor Rate Transition could create legal risks, in particular contract frustration (MPG Report, p.363-364). In order to limit those legal risks, the MPG Report recommends that a transition towards a successor rate would be supported by specific legislation that forces users of the “old” benchmark to transition to the successor benchmark. Such legislation is especially required in civil law jurisdictions, which include most of the EU member states (MPG Report, p. 43). Given that specific legislation supporting the transition towards a successor benchmark is unlikely to be available in many cases,

a transition to a successor rate may create legal risks. Therefore, the mere existence of substitute benchmarks is in itself not sufficient to determine whether a risk of force majeure/contract frustration/contractual breach exists.

The second criterion is also already implicitly but necessarily included in the third criterion (a reference to a substitute benchmark can only be made if a substitute benchmark exists).

Therefore EMMI believes that the second criterion does not need to be a separate criterion but should actually be an element of the third criterion.

The third criterion is the relevant criterion, but it should be broadened to include all relevant contractual clauses

In EMMI's view, the fundamental question with respect to the risk of force majeure/contract frustration/contractual breach relates to the question of contract continuity, namely if the non-compliant benchmark would no longer be provided, would the agreements that reference the non-compliant benchmark still continue by referring to a substitute benchmark (either a different, alternative benchmark or the existing benchmark with a new methodology that complies with the Benchmarks Regulation) or by providing another substitute solution.

To answer that question, one needs to look indeed at the third criterion, i.e. whether the financial contracts, financial instruments and investment funds (or their accompanying documents) already include fall-back provisions that directly or indirectly reference a possible substitute benchmark or provide for another substitute solution.

EMMI would like to stress however that there are also other contractual clauses that are relevant to answer the question of contractual continuity. To assess the risk of force majeure, contract frustration or other contractual breaches the whole contractual framework should also be taken into account.

The way in which the non-compliant benchmark is referenced in the agreements may also have an influence on contract continuity. If only the name of the benchmark is referenced, the tolerance for methodological changes required to adapt the non-compliant benchmark to the Benchmarks Regulation is likely to be higher than when the reference specifically refers to a certain methodology.

The specific way in which the benchmark is used in the agreement may also impact the risk of force majeure/contract frustration/contractual breach. For example, the use of a benchmark in mortgage agreements is likely to create a lower risk of force majeure/contract frustration/contractual breach than if the benchmark is used in derivatives.

From a practical point of view, it is likely to be unfeasible to analyse every agreement that references a non-compliant benchmark. With respect to the question of contract continuity, EMMI therefore recommends to analyse the contractual provisions under the (standard templates of the) most frequent contracts referencing the benchmark.

The third criterion is thus the relevant criterion with respect to the question of contract continuity, but the whole contractual framework should be taken into account, rather than only the fall-back clauses.

Proposal for a criterion that replaces the second and third criteria

Whether the existing financial contracts, financial instruments and investment funds (or their accompanying documents) referencing the non-compliant benchmark contain clauses that increase the chance of contract continuity if the non-compliant benchmark would be adapted to the Benchmarks Regulation. Such clauses may include fall-back clauses that reference to a possible substitute benchmark (and, if so, how such substitute benchmark has to be determined), the way in which the benchmark is referenced, the use which is made of



the benchmark, etc. The existence of such clauses may be analysed under the most frequent contracts referencing the benchmark.