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Additional Information

Level 1 Regulation

Benchmarks Regulation (BMR) - Regulation 2016/1011

Topic

Methodology

Subject Matter

Methodology and input data (ESMA70-145-114 Q&A 5.12)

Question

Can the methodology of a benchmark include factors that are not input data?

18-12-2018

Original language

Yes, the methodology of a benchmark can include factors that are not input data.

These factors should not measure the underlying market or economic reality that the benchmark intends to measure, but should instead be elements that improve the reliability and representativeness of the benchmark. This should be considered as the essential distinction between the factors embedded in the methodology and input data.

For instance, the methodology of an equity benchmark may include, together with the values of the underlying shares, a number of other elements, such as the free-float quotas, dividends, volatility of the underlying shares etc. These factors are included in the methodology to adjust the formula in order to get a more precise quantification of the equity market that the benchmark intends to measure, but they do not represent the price of the shares part of the equity benchmark.

A possible way to distinguish these parameters of the methodology (i.e. factors that are not input data) from the underlying input data is to consider the following difference between the two. Input data changes are taken into account by the methodology every time the value of the benchmark is to be updated, as they reflect the changes in the underlying economic reality measured by the benchmark. By contrast, changing values of the factors are not taken into account in every computation of the benchmark, but only in instances pre-determined by the methodology.

For example, the methodology of an equity benchmark could state that every quarter (i.e. four times a year) the market capitalisation of an issuer could be considered in order to decide whether its shares should still be part of the benchmark or not. Similarly, the methodology could include liquidity, volatility or free-float tests to be performed on the constituents of the benchmark e.g. on an annual basis. These and similar parameters when included in the methodology should not be considered input data. If instead, for instance, the methodology of an equity benchmark includes the use of one or multiple FX rate(s) every

time the value of the benchmark is updated, then such FX rate(s) should be considered as input data and treated accordingly (see obligations in BMR Article 11 on input data).

Factors that are not considered input data are relevant elements of the methodology, it is important that such factors comply with the requirements of Article 12 BMR on Methodology (e.g. benchmark being robust and reliable, clear rules on the exercise of any discretion, traceability and verifiability of the benchmark etc.) on an ongoing basis. Administrators are expected to use these factors in accordance with the predefined and BMR-compliant methodology and to ensure that all of the requirements of Article 12 are met whenever the methodology is implemented and the benchmark is determined.