

ESMA  
103 rue de Grenelle  
75345 Paris

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**The Investment Association**  
Camomile Court, 23 Camomile Street,  
London, EC3A 7LL

T +44 20 7831 0898  
E [enquiries@theia.org](mailto:enquiries@theia.org)  
W [theinvestmentassociation.org](http://theinvestmentassociation.org)  
Twitter @InvAssoc

**Date: 31 March 2016**

**Re: Discussion Paper – Benchmarks Regulation (ESMA/2015/288)**

The Investment Association welcomes the opportunity to respond to ESMA's discussion paper.

The Investment Association represents the UK asset management industry. Our members manage over £5 trillion in the UK of assets on behalf of UK, European and international clients, both retail and institutional. Collectively, our members make up the second-largest asset management industry in the world.

We would like to stress that, as we see it, the main purpose of the Benchmarks Regulation is to ensure that users of benchmarks, that is investors, have access to the benchmarks that they need, and that these are reliable.

Key issues arising from the discussion paper for our members include:

- The ESMA Guidelines on ETFs and other UCITS issues (ESMA/2012/832/EN) foresee that only transparent indices are permitted for UCITS to use as a benchmark. These transparency requirements are extensive, covering calculation, re-balancing methodologies, as well as constituents and their respective weightings. In addition, indices used as performance evaluation tools need to be disclosed in advance in the UCITS KIID. This existing Regulation complements existing industry practice around robust index selection necessary to perform to the highest fiduciary standards.

As such these Guidelines should be recognised in ESMA's output, particularly, the benchmark administrators should be required to state, in their Statement, whether their benchmark is compliant with the Guidelines.



- We consider that investment funds should be caught under the last section of the definition of 'use of a benchmark', and should not be caught under the first section, merely because it is also caught by the definition of 'financial instrument'.
- We would be concerned if the application process discriminated against, or made registration unnecessarily difficult for, non-EU providers or their indices.
- We do not support the introduction of either a fixed time limit or minimum threshold for triggering the Article 39 transitional provisions. The original Commission proposal had suggested triggers for imposing a time limit, and this was removed by the co-legislators.

Below, we have provided our responses to the questions raised in your paper.

Yours

Adrian Hood  
**Regulatory and Financial Crime Expert**



## Discussion Paper – Benchmarks Regulation

### Chapter 2: Definitions

**Q1. Do you agree that an index's characteristic of being "made available to the public" should be defined in an open manner, possibly reflecting the current channels and modalities of publication of existing benchmarks, in order not to unduly restrict the number of benchmarks in scope?**

The definition of 'making an index available to the public' needs to be precise so that everyone is clear as to which indices get caught.

It should be clear, from Recital 12 (which refers to 'benchmarks [which] are published and others [which] are made available, for free or upon payment of a fee, to the public or a section of the public'), that 'subscription only' indices are caught: however, an index created for one specific customer or supervised entity (or several closely related supervised entities if these are in the same group of companies) should not be caught, regardless of how it is used, even if this includes using the index in a way defined in the Article 3 definition, as the 'bespoke' index would not be 'published' or 'made available' to the public. The mere use of the index as a comparator for the performance of the fund, such that investors in the fund see a graphical representation of the index, should not be deemed to be making it public.

**Q2. Do you have any proposals on which aspects of the publication process of an index should be considered in order for it to be deemed as having made the index available to the public, for the purpose of the BMR?**

An index should only be deemed to be 'available to the public' if it is either: published freely for anyone who wishes to access; or is commercially available to anyone able to pay for it.

Firms, whether benchmark administrators or not, will produce indices which are not available to the public. These will include many which are produced on demand for one specific customer, often for one specific purpose. These may be a combination, or adaptation, of other indices which may well, themselves, be available to the public.



**Q3. Do you agree with ESMA's proposal to align the administering the arrangements for determining a benchmark with the IOSCO principle on the overall responsibility of the administrator? Which other characteristics/activities would you regard as covered by Article 3(1) point 3(a)?**

We support the alignment of the implementation with the pre-existing IOSCO principles, wherever possible.

There is an apparent hierarchy in the Regulation with Article 3(1)(5) setting out, at the highest level, what provision of a benchmark means: this includes administering the benchmark; but also the mechanistic process of collecting, analysing and processing the input data; and calculating the resultant index from the data.

Recital 16 then makes it clear that the administrator is the natural or legal person that has control over the provision of a benchmark (reinforced by the definition at Article 3(1)(6)). This then goes on to set out the way in which the administrator acts to show it 'has control' – the administrator must:

- administer the arrangements for determining the benchmark;
- collect and analyse the input data;
- determine the benchmark; and
- publish it.

Obviously, an administrator is able to outsource any of these functions. Recital 16 states that the mere publishing of a benchmark is not enough to result in the person doing so being the administrator.

IOSCO Principle 1 can then be used to flesh out the obligation of the administrator. The key aspects that identifies the entity actually responsible for the administration of the benchmark would seem to be the Determination and Governance of the benchmark.

A situation can be imagined where publicly available information is used to create an index. It is not those who produce the information that administer the benchmark, nor, necessarily, those who determine which figures should be used, or calculate the figures, but the entity which determines how this calculation is done, and controls that it is done properly.

**Q4. Do you agree with ESMA's proposal for a definition of issuance of a financial instrument? Are there additional aspects that this definition should cover?**



The definition of 'use of a benchmark' is one of the most important aspects of the Regulation, for the purposes of determining its scope and which firms are caught as a result.

The definition of 'use' is broken into several different activities, the first of which is 'issuance of a financial instrument' and the last of which relates to how investment funds 'use' benchmarks. Investment funds are defined (elsewhere) as an AIF or a UCITS. Both of these would be caught by the first half of the definition of financial instrument used in the Regulation if the definition of financial instrument is taken broadly.

Given that the first sub-definition of 'use' is wide in its scope, while the last is very specific, an inclusion of investment funds in the scope of 'financial instruments' as used in the first would render the last sub-definition otiose.

We understand ESMA's position (paragraph 28 on page 15) that, as financial instruments which are traded on a trading venue or SI are caught by the first sub-definition, that this catches those investment funds that are traded in such a way. We would suggest that ESMA should consider the counter-argument that the last sub-definition takes precedence for all investment funds. Clearly the rules were written so that investment funds were to be caught by the last sub-definition, and it could be claimed that making those investment funds which are admitted to trading, subject to the first sub-definition, goes against the intention of the legislators.

Notwithstanding the above, we strongly disagree with the vaguely worded nature of paragraph 30 to include within 'issuance of financial instruments' the creation of financial instruments which reference an index or a combination of indices (including investment funds) for the purpose of offering such instruments to third parties, with the aim to seek financial resources or other aims. Any such extension of the scope of the first sub-definition would entirely subvert the purpose of the last sub-definition.

While we recognise that some investment funds are traded on trading venues, the vast majority of them are not. The wording in paragraph 30 is too loose, and unjustifiable in light of the definition of 'financial instrument' which requires that the instrument must be admitted to trading, or traded, on a trading venue or SI.

Any final output should recognise either that an investment fund is not caught by the first sub-definition at all, or only if a request for admission to trading on a trading venue has been made or it is traded on a trading venue or on a systematic internaliser.

It is the last sub-definition which catches the use of benchmarks by investment funds.

**Q5. Do you think that the business activities of market operators and CCPs in connection with possible creation of financial instruments for trading could fall under the specification of**



**“issuance of a financial instrument which references an index or a combination of indices”? If not, which element of the “use of benchmark” definition could cover these business activities??**

No comment.

**No response to Q6 to Q33**

## **Chapter 5: Transparency of Methodology**

**Q34. Do you consider the proposed list of key elements sufficiently granular “to allow users to understand how a benchmark is provided and to assess its representativeness, its relevance to particular users and its appropriateness as a reference for financial instruments and contracts”?**

We agree with the proposed minimum requirements, and would suggest adding:

- the definition of the benchmark, including its objective, as this is a precondition for a sound understanding of the benchmark;
- the universe of the benchmark components;
- the basis on which benchmark components are selected; and
- the frequency of any periodic rebalancing of the composition.

ESMA should also require that benchmark administrators disclose whether their benchmarks are compliant with the ESMA UCITS Guidelines. Benchmark administrators should provide the details required to test this.

**Q35. Beyond the list of key elements, could you identify other elements of benchmark methodology that should be disclosed? If yes, please explain the reason why these elements should be disclosed.**

As stated in our answer to Q34, the benchmark administrators should disclose the information necessary under the ESMA Guidelines on ETFs and other UCITS issues. These transparency requirements are extensive, covering calculation, re-balancing methodologies, as well as constituents and their respective weightings.

Currently, collecting the information and data required under the ESMA Guidelines is an onerous and burdensome exercise for UCITS managers, as each benchmark administrator has different disclosure policies and practices in place. This currently depends on the willingness of the benchmark administrator.



As the ESMA Guidelines require the fund manager to have access to concrete data on the setting processes of an index, this access to the data should be granted to him.

**Q36. Do you agree that the proposed key elements must be disclosed *to the public* (linked to Article 3, para 1, subpara 1, point (a))? If not, please specify why not.**

Yes, the elements set out in paragraph 122 must be publicly disclosed.

As is clear in the recitals, while some benchmarks are published, others are made available, for free or upon payment of a fee, to the public or a section of the public. The information cannot, thus, be tied up so that only those who are paying customers have access to it, but must be available to all.

Potential users of benchmarks will need to have full information about the methodology of the benchmark prior to taking out a licence for its use.

From the recitals it seems that the purpose of the transparency of methodology, and to an extent, the Regulation itself, is to support market confidence, by ensuring the integrity of benchmarks. The manipulation or unreliability of benchmarks can cause damage to investors and consumers and this can be avoided by transparency about a benchmark's methodology.

As there will be now a legislative requirement for disclosures of the methodology of the Benchmark, we consider it fully appropriate and legally consistent to align the requirements coming from the ESMA Guidelines with the Benchmarks Regulation transparency requirements for administrators. All the main elements in Title XIII (Guidelines 49 to 62) of the ESMA Guidelines should be included in the list of the minimum elements that should be disclosed.

**Q37. Do you agree with ESMA's proposal about the information to be made public concerning the internal review of the methodology? Please suggest any other information you consider useful to disclose on the topic.**

We agree that the internal review of methodology should be carried out on a regular basis, and also in response to any unexpected developments.

Any such reviews should be public, and actively seek input from all relevant parties, including users, and potential users.



**Q38. Do you agree with the above proposals to specify the information to be provided to benchmark users and, more in general, stakeholders regarding material changes in benchmark methodology?**

Yes. Given the purpose of the Regulation, the proposed standards should represent a minimum level of transparency.

**Q39. Do you agree, in particular, on the opportunity that also the replies received in response to the consultation are made available to the public, where allowed by respondents?**

Yes. This should be the standard approach.

**Q40. Do you agree that the publication requirements for key elements of methodology apply regardless of benchmark type? If not, please state which type of benchmark would be exempt / which elements of methodology would be exempt and why.**

No comment.

**Q41. Do you agree that the publication requirements for the internal review of methodology apply regardless of benchmark type? If not, please state which information regarding the internal review could be differentiated and according to which characteristic of the benchmark or of its input data or of its methodology.**

Yes. As Recital 8 states that benchmarks that are currently not widely used could be used more in the future.

**Q42. Do you agree that, in the requirements regarding the procedure for material change, the proportionality built into the Level 1 text covers all needs for proportional application?**

No comment.





## **No response to Q43 to Q84**

### **Chapter 11: Benchmark Statement**

**Q85. Are there any further precise minimum contents for a benchmark statement that should apply to each benchmark beyond those stated in Art. 15(2) points (a) to (g) BMR?**

As in our answer to Q34, we would support the Benchmark Statement including, either the components and details necessary under the ESMA Guidelines on ETFs and other UCITS issues, or the confirmation of the administrator that the Benchmark is (or is not) compliant with the ESMA Guidelines.

If this Regulation is to create a safer context for the users of benchmarks, this would also mean that they should be able to avoid double burden for the information they need to obtain in order to comply with this Regulation as well as with other regulatory requirements.

## **No response to Q86 to Q98**

### **Chapter 13: Recognition and endorsement of third country administrators and benchmarks**

**Q99. Do you have any suggestions on which information should be included in the application for the recognition of a third country administrator?**

While agreeing with ESMA's analysis in paragraph 326 of the DP that the information to be provided by third country administrators should be aligned with the information to be provided in the application for authorisation by EU administrators, taking into account the specificities of the recognition process, it is important that the requirements on third country administrators be no more onerous.

We see one of the main purposes of the Benchmarks Regulation as being to ensure that the ultimate users of benchmarks, that is investors, have access to the benchmarks that they need, and that these are reliable. As many are produced by entities based outside the EU, their administrators should be able to obtain recognition for use in the EU, by applying, and complying with, the obligations imposed under the IOSCO Principles.

We would be concerned if the application for recognition discriminated against, or made registration unnecessarily difficult for, non-EU providers or their indices. Our concern is particularly for the smaller index providers who may be deterred from applying by what they might view as onerous requirements. The loss of this kind of



benchmark could significantly disrupt the benchmarks landscape in the EU, by reducing the range of index providers and concentrating market power in a few major index providers. This would, inevitably, lead to higher costs for benchmark users, and the ultimate investors. Preventing EU users from using reputable, robust and cost effective, but non-EU based, market indices would only operate to the detriment of European investors.

**Q100. Do you agree with the general approach proposed by ESMA for the presentation of the information required in Article 21a(6) of the BMR?**

While generally agreeing with ESMA's proposals we would re-iterate that the obligations and disclosure requirements imposed on non-EU benchmark administrators should be no more onerous than those imposed on EU-based administrators.

**Q101. For each of the three above mentioned elements, please provide your views on what should be the measures to determine the conditions whether there is an 'objective reason' for the endorsement of a third country benchmark.**

We consider that the prime criteria, connected to the need for proximity to the markets being measured, those contributing to the benchmark and specific nature of the economic reality being measured, is the location of the entity which has developed the index over time, creating a valued source of information, and the expertise required to manage and provide it.

Where there is no objective reason to consider that they are not conducting the business in line with the IOSCO Principles, then they should be allowed to continue to provide the index.

**Q102. Do you consider that there are any other elements that could be taken into consideration to substantiate the 'objective reason' for the provision and endorsement for use in the Union of a third country benchmark or family of benchmarks?**

Any determination that a non-EU benchmark provider does not have an objective reason for being based where it is, and its application for being endorsed by an EU-benchmark administrator thus failing, would result in potentially significant expense being incurred by those EU based entities that rely on the provision of the benchmark.



Investment funds which currently make use of such benchmarks have reported that any requirement to change to an alternative (which may well be less appropriate for the fund) would not only take a considerable length of time, involve considerable organisational work but also cost a lot of money.

Alternatively, any move to duplicate the benchmark within the EU would result in increasing the cost of the index, which would impact the underlying returns for any investors.

## Chapter 14: Transitional Provisions

**Q103. Do you agree that in the situations identified above by ESMA the cessation or the changing of an existing benchmark to conform with the requirements of this Regulation could reasonably result in a force majeure event, frustrate or otherwise breach the terms of any financial contract or financial instrument which references a benchmark? If not, please explain the reasons why.**

Yes, we agree that the ceasing or changing of a benchmark to conform to this Regulation would result in the frustration or otherwise breach the terms of the rules of any investment fund which uses them.

**Q104. Which other circumstances could cause the consequences mentioned in Article 39(3) in case existing benchmarks are due to be adapted to the Regulation or to be ceased?**

Ceasing or changing a benchmark, so as to frustrate the purpose for which a fund uses it, or render it inappropriate for an investment fund should be treated as a *force majeure* event.

**Q105. Do you agree with the proposed definition of "force majeure event"? If not, please explain the reasons and propose an alternative.**

The proposed definition seems reasonable.

**Q106. Are the two envisaged options (with respect to the term until which a non-compliant benchmark may be used) adequate: i.e. either (i) fix a time limit until when a non-compliant benchmark may be used or (ii) fix a**



**minimum threshold which will trigger the prohibition to further use a non-compliant benchmark in existing financial instruments/financial contracts?**

Of the two options we would be strongly in favour of the latter option. The use of benchmarks by investment funds must be considered. Most investment funds are open ended and not time constrained.

However, we would suggest that a better option would be not to impose any form of time limit on this provision. As ESMA noted, the original Commission proposal did suggest triggers for imposing a time limit, and this was removed by the co-legislators. ESMA should not be taking it upon itself to over-ride their express intention on this issue. We would support the replacement of the proposed thresholds by a continuing period for benchmarks and instruments/ contracts/ funds existing at the time of the entry into application of the Regulation

**Q107. Which thresholds would be appropriate to foresee and how might a time limit be fixed? Please detail the reasons behind any suggestion.**

Please see our answer to Q106.

**Q108. Is the envisaged identification process of non-compliant benchmarks adequate? Do you have other suggestions?**

Yes, this seems adequate. While benchmark providers may be reluctant to notify on the non-authorized or registered benchmarks administered by their competitors, they should be able to ensure that all of their own benchmarks are suitable authorized or registered.

Supervised entities should be aware of whether or not the benchmarks that they use have been registered, and motivated to notify those that have not been, to their competent authority.

Another critical point for users of a benchmark, is that during the transitional period it is not clear how a user of a benchmark would be informed if the competent authority refused a request for authorisation or registration of a benchmark on which they rely. In the Discussion Paper it is mentioned that in the case of refusal this information lies with the competent authority, but there is no provision as to how the users would be informed. This is a critical point for users as they could then be faced by their use of a benchmark suddenly being deemed to be in breach of the BMR. They would have no/minimal time to change to a substitute benchmark, if the transitional provisions of



Article 39(3) or (4) are not available. This would not leave sufficient time for a smooth transition to another benchmark.

**Q109. Is the envisaged procedure enabling the competent authority to perform the assessment required by Article 39(3) correct in your view? Please advise what shall be considered in addition.**

This does seem reasonable, as long as the specific interests of fund managers are remembered.

**Q110. Which information it would be opportune to receive by benchmark providers on the one side and benchmark users that are supervised entities on the other side?**

National competent authorities should provide clear, timely and accurate information on those benchmarks which have applied for authorisation or recognition, and any which have been refused (as covered in our answer to Q108).

**Q111. Do you agree that the different users of a benchmark that are supervised entities should liaise directly with the competent authority of the administrator and not with the respective competent authorities (if different)?**

This should be possible, as long as this information is available. It should also be possible for competent authorities to pass such information on to the correct competent authority.