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FESE Response to ESMA Consultation Paper on the Draft technical advice under the Benchmarks Regulation

Introductory remarks

The Federation of European Securities Exchanges (FESE) represents 35 exchanges in equities, bonds, derivatives and commodities through 20 Full Members from 29 countries, as well as 1 Affiliate Member and 1 Observer Member. FESE represents public Regulated Markets (RMs), which provide both institutional and retail investors with transparent and neutral price-formation.

At the end of 2014, FESE members had up to 9,051 companies listed on their markets, of which 7% are foreign companies contributing towards the European integration and providing broad and liquid access to Europe's capital markets. Many of our members also organise specialised markets that allow small and medium sized companies across Europe to access the capital markets; 1,442 companies were listed in these specialised markets/segments in equity, increasing choice for investors and issuers. Through their RM and MTF operations, FESE members are keen to support the European Commission's objective of creating a single market in capital markets.

FESE supports efficient, fair, orderly and transparent financial markets that meet the needs of well protected and informed investors and provide a source for companies to raise capital and for investors to hedge their portfolios. As such, exchanges can be regarded as neutral providers of data, and in certain cases also indices, but without any conflict of interest between trading activity leading to beneficial ownership and the provision of data and/or the provision of indices and benchmarks. FESE is registered in the European Union Transparency Register with number 71488206456-23.

FESE supports working with ESMA to construct a workable regime for benchmarks provided by trading venues.

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

In principle, FESE supports the broad definition suggested by ESMA for 'making available to the public'. FESE considers that the key objective of the BMR is to increase Investor Protection, including by promoting secure EU financial markets. In this context, it seems natural that any issued financial instrument within the EU which refers to an index provided within the EU should be seen as having been made available to the public by its inclusion as an underlying in a financial instrument or as a benchmark for performance evaluation impacting users as well as end investors. It should be kept in mind that even in cases where an index is not one of the broadly marketed indices within the EU, it might nevertheless have a significant impact on a subset of EU investors depending on their exposure to it.

FESE agrees with the open approach ESMA has taken for the media and modalities of publication. FESE supports the non-exhaustive nature of the list of dissemination media and modalities.

We agree with the general conditions detailed in the consultation paper. FESE supports the comparisons made to the IOSCO principles referenced in the introduction to this section as we consider these globally relevant guidelines provide a strong framework for the prevention of benchmark manipulation.

The overarching reason for introducing this legislation is to strengthen consumer and investor protection, therefore allowing potential loopholes in the regulation would clearly be unreasonable. In this context FESE supports ESMA's approach in saying that an index would have to be (at least potentially) accessible to an indeterminate and open group of recipients (e.g. one or more). We would like to ask ESMA to consider stressing in its final document that any issued financial instrument within the EU which refers to an index provided within the EU, irrespective of where it is administered, should be seen as having been published (i.e. made available to the public) alone by its inclusion as an underlying of any financial instrument in the EU.

FESE agrees with ESMA's approach into "customized basket of securities" where they are used solely for asset allocation purposes but would like to suggest that ESMA makes it clear in its RTS that where these baskets include a more formal calculation methodology, rather than just holding a security, that it should be included in the definition of an index. We see a risk that loopholes within the regulation might be generated by having something that is essentially an index masquerading as basket of securities.

FESE agrees with ESMA's suggestion that however the data is provided to recipients through whatever medium, with or without a license agreement, for payment or for free, should be considered as being made available to the public. We agree that creating an exhaustive list of communication channels could stifle growth and would not be future-proof.

FESE also agrees with ESMA that the frequency of dissemination should ideally be in line with the frequency of calculation but agrees that it could cause a loophole in the regulation. FESE would like to suggest that ESMA considers that the dissemination frequency should be in line with the published index methodology, which could go some way to remove the loophole mentioned.

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

FESE agrees with the draft technical advice. FESE supports ESMA's specification of what constitutes administering arrangements for determining a benchmark given that it is broadly in line with the IOSCO principles.

We agree that the creation or setting of a benchmark methodology is pivotally important for an administrator. FESE supports the suggestion of ESMA that any activity in relation to the provision of a benchmark can be outsourced or carried out by a third-party as long as the administrator remains in control of the performance of the outsourced activity. We wholly agree that the governance arrangements would fall under control rather than provision of a benchmark.

In the context of administering the arrangements for determining a benchmark ESMA is supposed to provide technical guidance on the details of the internal review and the approval of a given methodology, as well as the frequency of such review (Art 13 (1) (b) and (3) "Transparency of methodology"). We are well aware about Art 5 (3)(a) Oversight function requirements in this context, which requires that the oversight of the administrator encompasses the reviewing of a benchmark's definition and methodology at least on an annual basis. However, a fully rules-based methodology will not require a review with such a frequency while this requirement will be extremely costly while not providing any value-add to the market. There are Index Providers in the market providing several thousand indices, many of them rules-based and neither critical nor significant. In this context we would deem it most important that ESMA considers a proportionate approach as regards the frequency of reviews, in a way which is allowed under its mandate both for Art 5 and Art 13. FESE would like to propose that ESMA could at least have a consideration as regards the significance of a benchmark that takes into consideration if an index (family) is fully rules-based or not.

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, …)?

FESE supports ESMA's decision not to widen the concept of issuance to encompass derivatives. ESMA rightly recognises that trading venues do not issue financial contracts and should not be considered 'issuers'.

However, FESE is concerned by ESMA's statement that market operators are "caught under the second point (b) of the definition of 'use of a benchmark'. When determining the contract values or final settlement prices for financial instruments (which could be seen as the amount payable under a financial instrument), exchanges and/ or clearing houses do not benefit at all economically from changes of the value (price) of an index, having therefore no inherent conflict of interest.

Recital 19 states:

> *"Reference prices or settlement prices produced by central counterparties (CCPs) should not be considered to be benchmarks because they are used to determine settlement, margins and risk management and thus do not determine the amount payable under a financial instrument or the value of a financial instrument."*

Exchanges determine settlement prices as well and the recital clearly mentions settlement prices not being an amount payable. We therefore question whether exchanges can be placed under the scope of this second bullet as the term "amount payable" has not been defined.

Taking into account the above:

- The 'neutral' position, and
- The scope of the term 'amount payable'

FESE believes exchanges or clearinghouses do not belong to the "user definition" in the proposal, due to their neutral positioned services towards market participants and they are already highly regulated and supervised.

Please note: ICE does not agree with these comments.

Q4: Do you have any comments on the proposed specification of issuance of a financial instrument?

In general, FESE is supportive of ESMA's intention to clarify the definition of 'use of a benchmark' by capturing all different types of users of benchmarks – nevertheless, in our view, regulated markets are not, and should not be considered to be issuers under the Benchmark Regulation.

Please note: ICE does not agree with these comments.

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?

FESE considers that there is insufficient detail on how the nominal amount of financial instruments is to be calculated. It is not clear how an administrator can access this information. How it is to be determined which instruments/contracts/investment funds reference a benchmark.
There may or may not be a licence in place. When there is not a licence then it is not clear how the administrator can determine which instruments reference a benchmark.

FESE would like to make a number of practical comments in this respect:

- We support ESMAs consideration in paragraph 68 to broadening the regime for publicly available trade repository data.
- As many actors in this process will be calculating outstanding amounts on the benchmarks, it should be understood that is a 'work in progress'. There might be differences in how the data is aggregated, calculated or differences in approach to what is in scope between market participants and regulators. The process of coming to a decision on the outstanding value should be a process of discussion between the benchmark administrator and the regulator in order for both parties to come to an understanding.

Transitional regime specific topic:

- To use data from private providers of information will also help to calculate the threshold on the short term providing it will not generate extra costs for the 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?

With the following FESE would like to comment on Statement 79 and 80 within the consultation document.

FESE agrees that only a very small number of commodity benchmarks will fall into the category of critical benchmarks. However, when it comes to the seasonal pattern of some commodity prices or consumption volume it is not a matter of size, liquidity of the market or usage of a Benchmarks but of the characteristics of the underlying commodity. Commodities that follow seasonal patterns because of physical characteristics (e.g. non-storability, weather-dependency or season-driven consumption) do so even in relatively liquid markets. For these commodity benchmarks a six-month average is not adequate from our view as the seasonality tends to be spread over the whole year. As a result, we still propose to choose a yearly average as seasonal patterns should be levelled out.

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?

FESE does not support ESMAs suggestion to use license agreements to generate data for the calculation of thresholds due to various reasons as lined out below.

The license agreements of benchmark administrators should not be constrained by a demand of the licensor for these data, which are protected as proprietary and confidential information by many financial institutions. We would not feel comfortable – even if based on possible regulatory obligations – to have to breach any confidentiality clauses. While initially it might look like an easy solution to a significant challenge of gathering requested data in fact it is not. The width of index license arrangements varies significantly across the market and for many products (varying across administrators) no license agreements are even necessary, resulting in a lack of complete knowledge for those administrators as regards the use of respective benchmarks in the market and products in terms of overall value or number of instruments.

The way reports work today depends on the use of the benchmark in question. While for ETFs usually AUMs are being reported to the administrator, for other use cases only the number of referenced products may be reported or even none of them. This set-up of contractual arrangements has been chosen to avoid over-administration of benchmark users. Increasing the burden on users across benchmarks and across the EU would increase overall costs and potentially reduce choice of products for investors.

Q8: Do you agree with the criteria proposed? Do you consider that additional criteria should be included in the technical advice?

Q9: Do you think that the concept of "*significant share of*" should be further developed in terms of percentages or ranges of values expressed in percentages, to be used for (some of) the criteria based on quantitative data? If yes, could you propose percentages of reference, or ranges of values expressed in percentages, to be used for one or more of the proposed criteria?

FESE considers that it is unclear how the value of financial instruments etc. that reference a benchmark is to be sourced. This alternative method of determining the categorisation of benchmarks is still reliant on the value of financial instruments that reference a benchmark but there is no clarity as to how this value is to be sourced.

Q10: Do you agree with the suggested indicators for objective reasons for endorsement of third-country benchmarks?

FESE appreciates ESMAs considerate approach as regards endorsement of Third Country Benchmarks. While we understand and certainly share the regulators view that any misuse of endorsement shall be prevented (as already clearly lined out in the L1 text), FESE would like to point out that global markets require global indices. In this respect, FESE appreciates an approach which allows for diversity of indices within the EU while protecting EU investors and market participants.

The model of endorsement provides for a sensible solution especially in such cases where certain globally established benchmarks with a larger subscriber-base outside the EU are being made available in, the EU market and to EU investors. Third Country administrators of such benchmarks would most likely not consider relocating, neither would they consider submitting their IP rights to any EU located administrator. In such cases, endorsement is of significant value to the EU market and should be supported as much as possible.

That said, we would appreciate an explicit confirmation from ESMA that the avoidance of a significant increase of costs borne by benchmark users is an analogous advantage to the users as a reduction of costs. If endorsement in the EU required transitioning of the benchmark operations to an EU entity, this would be a significant cost burden that would ultimately have to be passed down to the benchmark users.

<u>New global benchmarks providers</u>

FESE deems it important that not only existing benchmarks are being considered for endorsement, but also new ones in order to not exclude potential options for the EU market from the beginning.

Therefore, FESE is concerned that the proposed approach does not sufficiently take into account the newer global index providers. The Consultation Paper states that an index provider with a large subscriber-base outside the EU could use this fact as a valid objective reason for endorsement. We believe that this phrase would create unnecessary, higher entry barriers for new index providers to offer

their services within the EU, thus creating an anti-competitive environment and potentially disadvantaging EU benchmark users.

Thus, we strongly suggest that ESMA consider softening or expanding this language so as not to create a competitive landscape that discourages new index providers from offering services to EU benchmark users.

Additional objective reasons for endorsement

Moreover, we propose including the following additional objective reasons for endorsement.
IOSCO Principles for Financial Benchmarks

According to the Recital (34), the Regulation should take into account the IOSCO Principles for Financial Benchmarks which serve as a global standard for regulatory requirements for benchmarks. FESE believes it would be prudent for ESMA to consider adding to the exhaustive list of valid objective reasons one such that following the IOSCO Principles with formal policies and procedures, combined with an EU presence, would be a strong and valid objective reason for third-country benchmark endorsement.

Historical presence in a third country

We furthermore believe that the endorsement provisions in the BMR were drafted with the specific aim to prevent regulatory arbitrage (i.e. preventing benchmarks currently provided in the EU from moving to third countries in order to benefit from a lighter regulatory regime). However, administrators of benchmarks historically provided from third countries (i.e. in advance of the development of the BMR) by definition have not based their decisions on the existence of the BMR. The addition of the criteria "historical presence in a third country" to the list of objective reasons should therefore allow benchmarks historically provided from third countries directly to qualify for endorsement.

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?

FESE generally welcomes ESMAs proposal as regarding the transitional provisions, while we would recommend an adapted wording in the case of transition to another benchmark, which currently seems to be too generic thus leaving unwanted room for interpretation.

FESE explicitly welcomes ESMAs approach as regards leaving certain discretion to NCAs when reviewing a non-compliant benchmark. Benchmarks may differ in nature as well as in use and thus discretion might be necessary. We appreciate, however, that while discretion shall be applied by NCAs, transparency about the decisions as well as the reasoning shall be provided to the public, thus limiting any potential un-level playing field.

We explicitly welcome as well ESMAs intension to apply a non-exhaustive list of criteria on which the assessment of a non-compliant benchmark should be based on, as well as the case by case approach. We appreciate that ESMA will liaise with the benchmark provider in order to use his experience within

the process and would like to encourage that this might not be only for certain selected tasks. A close co-operation could be beneficial for all parties including the market.

However, the current wording applied by ESMA as regards transitioning of a benchmark most likely referring to a similar benchmark provided by another benchmark provider - seems to unfortunately give rise to unwanted interpretation. The wording currently suggested by ESMA may be interpreted in a way that the benchmark administrator who failed to become compliant with the requirements as lined out in the BMR within the set time frame (for whatever reasons) would have to submit its IP rights to another benchmark provider, which would constitute a de facto disappropriation. In fact, even in case a benchmark might not suffice all EU BMR requirements, it could still hold a significant value outside of Europe.

We are in fact not even convinced that this is what ESMA had in mind when formulating the Draft Technical Advice and assume that ESMA was referring to "substitutes of benchmarks" which are referenced to in various parts of the BMR. In this case another Benchmark Administrator (or even the same) operates a benchmark which is a close substitute of the benchmark in question. We would therefore like to propose a different wording:

6.4 Draft Technical Advice on transitional provisions

2. (bullet 5)

- "whether the transitioning of **assets referencing** the benchmark **in question** to **a similar but compliant benchmark provided by** another administrator would lead to a substantial change in the benchmark".

Again, when reviewing this, we would recommend to include the benchmark provider of the non-compliant benchmark within the process as well.

Finally, we would like to ask if ESMA foresees any time limit for the decision making process of the NCA.