



ADVICE TO ESMA

Response to ESMA's Consultation Paper on Draft technical standards under the Benchmarks Regulation

I. Executive summary

The SMSG considers that indices are fundamental as they may underpin an investment strategy, serve as underlyings or even reflect the state of an economy. The Benchmark Regulation will introduce important rules and requirements and following its implementation, correct supervision and enforcement will be essential in order to avoid future cases of benchmark manipulation.

Overall, the SMSG compliments ESMA on its work and agrees to the draft technical standards. It recommends to ESMA to consider the following issues:

- 1. Oversight function: ESMA should reconsider whether two independent members of the oversight function is sufficient.*
- 2. Transparency of Methodology: ESMA should further assess how administrators should consult on material changes to the benchmark's methodology in case of sudden market events.*
- 3. Governance and control requirements: ESMA is asked to reconsider whether all submitters, should have to demonstrate their understanding and knowledge on an annual basis, independently of the characteristics of the benchmarks.*
- 4. Benchmark Statement: ESMA should consider allowing the possibility for non-significant benchmarks to cross-reference the methodology under Article 13 for the purpose of its benchmark statements requirements.*
- 5. Recognition of an administrator located in a third country: ESMA should provide as of 1st January 2018 a quarterly progress report on third-country benchmark recognition.*
- 6. Pricing of critical Benchmarks: While the SMSG is cognisant that there is no clear mandate in Level 1 to empower ESMA in this area, nevertheless a majority of the SMSG voiced their concerns that given the stickiness of the use of some benchmark providers and a market structure environment that doesn't encourage multiple providers, that pricing and price changes should be made transparent.*
- 7. The SMSG recommends ESMA to review its guidelines on ETFs and other UCITS issues so that the level of due diligence required from asset managers on index methodology is consistent with the level of transparency of methodology benchmark administrators are required to provide by the technical standards under the Benchmark Regulation.*

II. Background

1. The role of the SMSG

1. The Securities and Markets Stakeholder Group (SMSG) advises ESMA on all regulatory and supervision matters. In compliance with EU Law, it is composed of expert representatives of financial market participants operating in the Union, of their employees, of consumers, of users of financial services and of independent top-ranking academics.

2. Purpose of this Advice

2. The SMSG wishes to use the opportunity of the publication of ESMA's Consultation Paper on draft technical standards under the Benchmarks Regulation to provide a high-level advice to ESMA.
3. The SMSG considers that indices are fundamental as they may underpin an investment strategy, serve as underlyings or even reflect the state of an economy. Therefore, indices should be underpinned by universally agreed principles of good governance, sound methodology and transparency, in order to provide investors with the adequate level of protection and to limit risks of conflicts of interests and manipulation.
4. The Benchmark Regulation will introduce important rules and requirements and following its implementation, correct supervision and enforcement will be essential in order to avoid future cases of benchmark manipulation. Rules alone will not prevent abuses, but supervision and enforcement will be key to strengthen consumer protection.

III. Summary of ESMA SMSG views on technical standards of the Benchmarks Regulation

1. Oversight function

5. The SMSG agrees with the proportionality ESMA has developed for the oversight function as critical benchmarks and benchmarks more susceptible to manipulation should be subject to stronger oversight arrangements.
6. For critical benchmarks, ESMA should reconsider whether two independent members of the oversight function is sufficient. The SMSG considers that a bigger involvement of independent members, e.g. a proportional minimum threshold and/or at least three independent committee members would be beneficial for the quality of oversight.

2. Input Data

7. In principle, the SMSG considers ESMA's approach for input data appropriate. The administrator should assess the appropriateness of data to measure the market or economic reality and administrators should keep clear and complete records to ensure that data can be verified, evaluated and validated. The SMSG also supports ESMA's overall simplification of the record keeping requirements and the proportional approach taken on verifiability to different types of data. The SMSG considers it appropriate that benchmarks more vulnerable to manipulation are subject to stricter requirements.

3. Transparency of methodology

8. The SMSG supports the suggested key elements of the methodology as developed by ESMA. The SMSG also supports ESMA's proposal to leave some discretion to administrators in setting the frequency of reviews. This approach is appropriate since the frequency of reviews is dependent on the nature of the benchmark and its related market.

9. However, the SMSG considers that ESMA should further assess how administrators should consult on material changes to the benchmark's methodology in case of sudden market events. ESMA currently states that no exceptions can be made regarding the obligation to consult, not even in sudden market conditions, but this approach risk resulting in benchmarks not correctly measuring the related market reality. The SMSG would support a simplified procedure or an emergency procedure that could be used when 'sudden market events' have been demonstrated.

4. Code of conduct of contributors

10. The SMSG supports the elements of the code of conduct developed by ESMA.

5. Governance and control requirements

11. The SMSG supports the ESMA proposal regarding measures to manage conflicts of interests for the process of contribution of input data. It is important that internal procedures are adequate and that submitters are separated from other employees.
12. However, ESMA is asked to reconsider whether all submitters, should have to demonstrate their understanding and knowledge on an annual basis, independently of the characteristics of the benchmarks for which they act as submitter and their respective levels of experience.

6. Criteria for significant benchmarks

13. The SMSG supports the criteria developed by ESMA.

7. Compliance statement for administrators of significant and non-significant benchmarks

14. The SMSG supports the proportional ESMA proposal, whereby non-significant benchmarks can submit less extensive compliance statements compared to significant benchmarks.

8. Benchmark statement

15. The SMSG supports the ESMA proposal for benchmark statements requirements. However, in the interests of proportionality, ESMA should consider allowing the possibility for non-significant benchmarks to cross-reference the methodology under Article 13 for the purpose of its benchmark statements requirements.

9. Authorisation and registration of an administrator

16. The SMSG supports the ESMA proposal for information required to apply for authorisation and registration. In particular, the SMSG supports that information can be provided on the level of family of benchmarks, subject to certain conditions.

10. Recognition of an administrator located in a third country

17. The SMSG supports ESMA's proposal to allow recognition through demonstration of compliance with the Benchmarks Regulation by applying IOSCO principles in a manner consistent with the Regulation as certified by an independent external auditor. The SMSG also supports that the application should be in one of the EU official languages and comply with the International Financial Reporting Standards or with Generally Accepted Accounting Principles. In order to monitor progress on the availability of third-country benchmarks in the EU, the SMSG recommends that ESMA should provide as of 1st January 2018 a quarterly progress report on third-country benchmark recognition and ideally provide transparency to the market on pending approvals before that date.

11. Pricing of critical Benchmarks

18. While the SMSG is cognisant that there is no clear mandate in Level 1 to empower ESMA in this area, nevertheless a majority of the SMSG voiced their concerns that given the stickiness of the use of some benchmark providers and a market structure environment that doesn't encourage multiple providers, that pricing and price changes may not be in line with Art. 22 of the regulation, which states for critical benchmarks that they need to be provided on a fair, reasonable, transparent and non-discriminatory basis. The majority of the SMSG would recommend:
19. Benchmark providers as part of their authorization or re-authorisation application should be expected to clearly explain their initial pricing and the parameters/process for price changes during the authorization period.
20. The parameters/process for price changes should form part of the contractual agreements between the benchmark provider and customers of the benchmark providers.

12. ESMA guidelines on ETFs and other UCITS issues

21. The SMSG recommends ESMA to review its guidelines on ETFs and other UCITS issues so that the level of due diligence required from asset managers on index methodology is consistent with the level of transparency of methodology benchmark administrators are required to provide by the technical standards under the Benchmark Regulation.

This advice will be published on the Securities and Markets Stakeholder Group section of ESMA's website.

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