



European Securities and  
Markets Authority

# Methodological framework

**Selection of supervised entities for mandatory contribution under  
Article 23(7) BMR**





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## 1 Executive Summary

Article 23 of Regulation (EU) 2016/1011 (BMR) provides that under certain circumstances a competent authority can require supervised entities to contribute to a critical benchmark. The selection of the supervised entities shall be made on the basis of the size of a supervised entity's actual and potential participation in the market that the benchmark intends to measure.

ESMA has developed this methodological framework to promote the convergence of the supervision of specific types of critical benchmarks. The framework may be considered by competent authorities of administrators of the relevant critical benchmarks when they select the supervised entities that are to be required to contribute input data.

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## 2 Introduction and background

1. Article 20 of Regulation (EU) 2016/1011 (“BMR”)<sup>1</sup> relates to benchmarks provided by administrators within the Union that are considered to be critical benchmarks if one of the conditions within Article 20(1) is met. The same Article requires the European Commission to establish and review a list of critical benchmarks.
2. Critical benchmarks are subject by virtue of the BMR to specific requirements that are more stringent to those applying to other types of benchmarks, i.e. significant and non-significant benchmarks.
3. Article 23 of BMR provides that in certain circumstances a competent authority can require a supervised entity<sup>2</sup> to contribute input data<sup>3</sup> to a critical benchmark. The Article applies to critical benchmarks that are based on submissions by contributors, the majority of which are supervised entities. Article 23(6) of BMR provides that the maximum period of mandatory contribution shall not exceed 24 months in total.
4. Article 23(7) of BMR provides that where the circumstances apply, the competent authority of an administrator of a critical benchmark shall, with the close cooperation of the competent authorities of the supervised entities, select supervised entities required to contribute to the critical benchmark *“on the basis of the size of the supervised entity’s actual and potential participation in the market that the benchmark intends to measure”*.
5. To promote convergence in relation to the supervision of critical benchmarks, ESMA has developed the criteria set out in this framework to assist competent authorities (NCAs) in their selection of supervised entities to be required to contribute input data to critical benchmarks.
6. At this stage, ESMA has developed this framework with reference only to Interbank Offered Rates benchmarks (or “IBORs”) and the Euro OverNight Index Average (“EONIA”).
7. The list established by the European Commission of critical benchmarks includes only EURIBOR<sup>4</sup>. However, other IBOR benchmarks or the EONIA might be considered to qualify as critical in the future. Where applicable, competent authorities of administrators of IBORs might therefore use this framework to select the supervised entities to be required to contribute to a critical benchmark whose representativeness is at risk. ESMA recognises that different IBORs have different characteristics and methodologies and that this framework should take into account these differences.
8. ESMA has adopted in this framework an approach to take into account the general characteristics of the different IBORs in the European Union that are potential candidates for inclusion in the list of critical benchmarks of the Commission. In developing its approach, ESMA has considered existing IBOR methodologies and has included some examples for illustrative purposes only (grey boxes). ESMA is aware that NCAs may have to develop further their national approach where that is necessary in order to take into account the

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<sup>1</sup> Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds.

<sup>2</sup> A ‘supervised entity’ is defined in in point (17) of Article 3(1) of BMR

<sup>3</sup> ‘Contribution of input data’ is defined point (8) of Article 3(1) of BMR as: *“providing any input data not readily available to an administrator, or to another person for the purposes of passing to an administrator, that is required in connection with the determination of a benchmark, and is provided for that purpose”*.

<sup>4</sup> COMMISSION IMPLEMENTING REGULATION (EU) 2016/1368 of 11 August 2016 establishing a list of critical benchmarks used in financial markets pursuant to Regulation (EU) 2016/1011 of the European Parliament and of the Council <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R1368&from=EN>

specific characteristics of individual benchmarks. This methodological framework may take into account the outcome of any such future developments and ESMA may update this document accordingly.

9. The definition of a supervised entity in BMR covers a range of entities including credit institutions<sup>5</sup>. ESMA considers that, in the case of the IBORs, credit institutions will be the most likely type of supervised entity to be subject to mandatory contribution. The eligibility of supervised entities as potential contributors to a benchmark will also typically be determined by the definition of a panel bank in the methodology and/or by the underlying interest of each benchmark.
10. Another aspect of the selection that is defined in the methodology of the benchmark, and that depends on the characteristics of each benchmark, is the market that the benchmark intends to measure. IBORs generally intend to measure the unsecured inter-bank deposit market. However, different IBORs have different characteristics, and these should be taken into consideration in the methodology used for selecting supervised entities to contribute to the IBOR.
11. It is important to highlight that the criteria that the supervised entity should meet to be selected to contribute input data to the administrator will be determined in part by the administrator's current methodology or by the methodology that a competent authority has directed the administrator to use under point (d) of Article 23(6) of BMR.
12. The next sections of this document are organised as follows: section 3 includes the elements identifying the transactions that could be considered for the measurement of the size of the actual participation in the market the benchmark intends to measure; section 4 includes examples of potential related markets that could be considered for the assessment of the size of the potential participation in the market the benchmark intends to measure; section 5 includes additional elements of analysis that could be considered.

### **3 Size of the actual participation in the market**

13. The actual participation of a supervised entity in the market refers to the effective trading activity of that same supervised entity in the market that the benchmark intends to measure. The size of this actual participation in the market can be measured by the volume of the transactions of that supervised entity in the market that the benchmark intends to measure. Competent authorities could also use the number of transactions while analysing the size of the actual participation in the market.
14. The characteristics of the transactions to be included in the measurement of the actual participation in the market are highly dependent on the underlying interest and the methodology of the benchmark. Therefore, depending on the market that the benchmark intends to measure, different characteristics of transactions would be considered as part of the underlying market of the benchmark. In the case of IBORs, transactions could be selected according to the following criteria, where applicable to the benchmark methodology:

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<sup>5</sup> This definition refers to the definition in point (1) of Article 4(1) of Regulation (EU) No 575/2013 of the European Parliament and of the Council: "an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account".



- (a) The currency of the transactions. The currency of transactions depends on the currency of the market that the benchmark intends to measure.

For example for EURIBOR, only the transaction denominated in EUR will be selected.

- (b) The maturity of the transactions. Depending on the market the benchmark intends to measure, all relevant maturities could be examined.
- (c) The types of the transactions. Depending on the underlying interest and the methodology of the benchmark, different types of transactions could be included.

For example for EURIBOR the types of the transactions include unsecured deposits.

- (d) The counterparty types. Benchmark methodologies may specify the counterparty types of the transactions that should be included in the market that the benchmark intends to measure

For example, for EURIBOR the counterparty types include financial institutions.

- (e) The geographical location of the transactions. IBORs generally measure the unsecured inter-bank deposit market in a particular geographical region.

For example, for EURIBOR the geographical location of the transactions is the EMU zone.

15. It is important to highlight that the analysis in this section is highly dependent on the availability of appropriate data in relation to the transactions covering the underlying market the benchmark intends to measure. The competent authority of the administrator could gather data from data providers and/or market participants and/or could involve other competent authorities and central banks.

16. Alongside looking at the actual participation of the supervised entity, the NCA should also consider potential participation. As part of that, the competent authority may apply the criteria developed in the following section on the potential participation in the market in order to have a comprehensive assessment of each supervised entity.

## **4 Size of the potential participation in the market**

17. The competent authority of the IBOR's administrator shall, according to Article 23(7) BMR, also take into account the size of the supervised entity's potential participation in the market. Although ESMA acknowledges that the BMR requires the actual and potential participation cumulatively, where possible, priority should be given to a supervised entity's

actual trading activity in the relevant market. The priority of actual participation over potential participation in the market the IBOR intends to measure is also reflected in the selection criteria set out in Section 5.

18. To assess the size of the supervised entity's potential participation in the market, NCAs could consider the supervised entity's activity in related markets and, as applicable, the activity of other entities in the same group of that supervised entity. In general, related markets could include:

- (a) the unsecured inter-bank deposit market in the currency of the market the IBOR measures (if other than the market that the IBOR intends to measure);
- (b) other unsecured deposit markets, including certificates of deposits and commercial papers in the currency of the market the IBOR measures (if other than the market that the IBOR intends to measure);
- (c) the unsecured inter-bank deposit market in another currency (if relevant to the methodology of the benchmark);
- (d) repurchase agreements and activity in secured markets, overnight lending or borrowing activity;
- (e) other loan or debt markets in the currency of the market the IBOR measures;
- (f) other loan or debt markets in another currency (if relevant to the methodology of the benchmark).

19. The list is derived from the proximity and similarity of each related market to the unsecured inter-bank deposit market that will be the market that an IBOR intends to measure in most cases. This list is dependent on the benchmark methodology as outlined in some instances above.

20. NCAs can consider a supervised entity's activity in other markets or other factors that are relevant to the assessment of the size of the supervised entity's potential participation in the market the benchmark intends to measure.

## **5 Selection of supervised entities after size assessment**

21. The assessment of the size of actual and potential participation in the market, applying the criteria set forth in this framework, may lead to a broad group of supervised entities that are fit to be mandated to contribute to the relevant IBOR. The BMR gives priority to transactions as the preferred input data (paragraph 1 of Annex 1 for interest rate benchmarks of BMR). A supervised entity's actual participation in the relevant market should therefore have the adequate importance for the selection of the mandated contributors, where the market is sufficiently active and supervised entities trade in significant volumes.

22. Therefore, ESMA considers that the weighting of the actual participation in the market should be greater than the potential participation in the market. At the same time, and to include the cases where the market does not incorporate sufficient or any transactions it is also important to keep a sufficiently high level of weighting for the potential participation in the market.

23. A second criterion that might be included in the selection of supervised entities, particularly when the methodology of the benchmark indicates it, is the creditworthiness of the supervised entity to be compelled for contribution to the benchmark.

The definition of EURIBOR refers to the rate at which the panel bank estimates that any other bank would borrow funds. The characteristics of the panel bank, e.g. the creditworthiness are not to be considered as the bank could have an expertise in the market the benchmark intends to measure although the bank has a low creditworthiness. An analysis of the creditworthiness of EURIBOR panel banks as of April 2017, reveals that some banks in the panel do not have an investment grade creditworthiness. However, as stated above, the EURIBOR definition does not refer to the rate at which the panel bank would offer euro interbank term deposits but rather at which rate the panel bank thinks that banks within the EMU zone would offer Euro interbank deposits.

24. Finally, after the selection of the supervised entities according to the size of actual and potential participation and other criteria such as the creditworthiness, the NCA might consider which supervised entity's/entities' contribution would result in a benchmark's renewed representativeness. In other words, the NCA may consider the number of supervised entities that it should compel to contribute in order for the benchmark to be representative of the underlying market. If sufficient data is available, the NCA might statistically compare the value of the benchmark derived from all panel banks including the newly selected ones to the value of the benchmark derived from the market that the benchmark intends to measure. Following the application of the criteria set out in this framework, the NCA of the administrator, with the close cooperation of the competent authorities of the supervised entities, can exercise some discretion when choosing supervised entities for mandatory contribution and may take aspects of proportionality into consideration, including the costs that a supervised entity will actually or typically incur and the prospective time frame for a supervised entity to set up the contribution to the benchmark.