



FESE response ESMA consultation on Benchmarks Regulation RTS

Brussels, 5th June 2020

1. Introductory remarks

FESE welcomes the opportunity to provide comments on the Benchmarks Regulation (BMR) draft RTS. BMR applies to all benchmarks, regardless of the underlying market. However, different types of benchmarks pose different types of risks to the markets. From a global perspective - where many developments have taken place - IOSCO has recognised that benchmarks based on regulated data should be subject to a proportionate approach. BMR acknowledged that regulated data benchmarks are less prone to manipulation. Nevertheless, experience with its application has shown that the framework does not differ much from that of other types of benchmarks.

In this context, FESE considers that there overall appears to be a lack of proportionality in the suggested RTS as regulated data benchmarks are mostly suggested to be covered by the same provisions as other benchmarks. FESE would therefore support changes to the draft RTS to better reflect benchmarks' respective risk profiles. Please see our detailed suggestions included below.

Governance arrangements

Q1 - Do you agree with the governance arrangements set above? Do you have any additional suggestions? Please specify.

FESE considers that the draft RTS does not allow for sufficient proportionality. While ESMA states that the "concept of "robust governance arrangements" should be interpreted in accordance with the nature, scale and complexity of the benchmark administrator", the proposed RTS only suggests small alleviations for non-significant benchmarks compared to other benchmarks. Moreover, ESMA proposes that benchmarks based on contribution data and regulated data benchmarks, where the latter are much less susceptible to manipulation, be subject to the same requirements. FESE would therefore support changes to the draft RTS to better reflect benchmarks' respective risk profiles in terms of robustness. In addition, we do not agree with ESMA's statement in paragraph (5) that in case an administrator administers different types (i.e. non-significant, significant or critical) of benchmarks, the most stringent requirements should apply to them. This would negate the regimes applicable to non-significant benchmarks and disapply any proportionality.

In addition, some of the provisions proposed might not be well suited to Exchanges that are also benchmarks administrators. As Exchanges are already covered by MiFID II/MiFIR governance requirements they could potentially become subject to overlapping divergent requirements. Moreover, it should be taken into account that benchmarks administrators can be part of a larger group and policies at group level should be allowed. We do therefore not agree with ESMA's approach in paragraph (8) where ESMA suggests a cumulative approach. This would not only lead to a disproportionate burden but possibly also to applying rules that in practice would conflict, especially where group policies and benchmark related policies

would cover the same topic. Indeed, leveraging existing frameworks as suggested would be recommendable.

Q2 - Do you agree that administrators should have in place a remuneration framework?

FESE is not in favour of a separate remuneration framework. The BMR is very clear regarding handling of Risk of Conflict and we see no need for further elaborations nor separate framework.

As currently drafted Article 1(5) may be problematic for benchmark administrators which are part of a wide corporate group which sets remuneration policies centrally. We suggest a modification as follows:

“5. Administrators shall ~~establish a remuneration framework~~ to ensure that the remuneration of the persons involved in the provision of the benchmark is appropriately set and is not subject to conflicts of interest.”

Q3 - Do you agree that the same requirements should apply to an administrator that is a natural person? Please elaborate.

N/A

Methodology

Q4 - Do you think that other conditions should be taken into account to ensure that the methodology complies with the requirements of the BMR? Please specify.

FESE does not consider that any other conditions are needed.

In relation to proposed provisions regarding the type of data to be used, FESE agrees that transaction data should preferably be used where available. However, for certain benchmarks, such as commodity benchmarks and certain bond benchmarks, it might not be possible to use transaction data in all cases. It should therefore still be possible to use other types of input data, including quotes.

Article 4(1) of the draft RTS requires an impact assessment using hypothetical data for unrealised stressed market conditions. It is unclear what type of data would be required for this. In paragraph 44, ESMA states that the benchmark is resilient to market circumstances so that it does not cease in case of adverse circumstances. While in general we understand this statement, it must be noted that certain types of benchmarks actually do cease to exist in those types of circumstances, notably short and/or leveraged indices which is the prudent approach in our view.

Q5 - Do you consider that additional requirements are needed to ensure that the methodology is traceable and verifiable? Please specify.

FESE does not consider that any additional requirements are needed.

Q6 - Do you think that the back-testing requirements are appropriate? Please specify.

FESE considers that the proposed requirements for back-testing as proposed in the draft RTS Article 3.2e are very far-reaching and that a more proportional approach should be considered for regulated data benchmarks.

While ESMA repeatedly outlines that benchmarks based on transaction data are less prone to manipulation, it is still suggested that regulated data benchmarks be subject to the same requirements as benchmarks based on contribution data. Only non-significant benchmarks are suggested to benefit from some alleviations in terms of not having to apply all provisions.

Regarding the provisions on benchmarks' resilience, it should be recognised that circumstances may arise that could require adaptation of the benchmark's methodology.

While FESE agrees that the methodology should in principle be consistent over time, there may be events which require swift action from the benchmark administrator regarding methodology adaption. This type of event may make a deviation from usual processes necessary. FESE fully agrees that this would be extraordinary circumstances only, nevertheless, these should be considered by ESMA. Not allowing for emergency adaptations would not only negatively impact EU investors but also non-EU investors and EU benchmark providers as their benchmarks would potentially be less resilient compared to non-EU benchmarks. In a global competitive market, this would negatively impact EU benchmarks' competitiveness.

The back-testing requirements as currently drafted are not appropriate but need to be more specific. Please see below for details:

Paragraph 36.a / Article 3.1 of the relevant Draft Regulation requires further details in order to become actionable. How is the "assessment of the adequacy and appropriateness of the historical values of the benchmark" to be performed? What are the criteria for the assessment? Input data utilised in a back-test are not estimated by the benchmark administrator but typically sourced from exchanges via data providers.

Paragraph 39 / Article 3.2 of the relevant Draft Regulation: "The back-testing against available transaction data should be an ex-post back-testing which compares the observed outcome of the level of the benchmark based on transaction data to the expected outcome derived from the use of the methodology." is unclear. The back-test is by definition executed by applying the methodology to past transaction data (or the input data stated in the methodology) and is performed before the benchmark goes live. Once the index is live, there cannot be any difference between the live index data and a back-test performed on the same live period since the algorithm and data are the same. Moreover, it is not clear what is meant by "the expected outcome derived from the use of the methodology"?

Paragraph 40 / Article 3.2 of the relevant Draft Regulation is not clear as to what the index provider is asked to do and what the aim is, therefore, the requirement cannot be properly assessed.

In particular, the statement "In order for the back-testing to be meaningful and the methodology to be reviewed, if needed, following the back-testing results, the administrator should consider clear statistical tests to assess the back-testing results. The administrator should have a documented process regarding the action it would take depending on the results of the back-testing on a case by case basis." requires further explanation as to how this should be actioned, i.e. what type of statistical tests are expected to be performed in order to validate the back-test with regards to the application of the methodology to input data. Input data utilised in a back-test are not estimated by the benchmark administrator, but typically sourced from Exchanges via data providers.

Paragraph 44 / Article 4 of the relevant Draft Regulation: "The administrator should ensure that the methodology is resilient to adverse market conditions and therefore the benchmark would not lose representativeness or be ceased in such circumstances." should be put into context. Benchmarks that are built as portfolios of tradeable securities make use of input data typically provided by Exchanges in the form of traded prices, quotes or settlement data and thus should intrinsically reflect the evolving underlying economic reality also in adverse market conditions.

The benchmark provider should have in place an effective governance framework that allows them to take decisions tailored to the nature of the exceptional and unforeseeable circumstances: this is the sole solution that truly allows an index to remain resilient and representative in exceptional circumstances. Back-tests should be executed by applying, to the largest extent possible, the same methodology that will be applied by the index when live. Input data should hence be of the same nature as prescribed by the methodology. Deviations may be allowed in case the required type of data is not available historically or the costs associated with their purchase are deemed not proportionate.

Reporting of infringements

Q7 - Do you agree with the requirements set out above? Do you have any additional suggestions? Please specify.

FESE welcomes the proportional approach proposed by ESMA whereby regulated data benchmarks and certain commodity benchmarks would not be subject to this RTS due to the character of the input data used for these types of benchmarks.

Regarding the proposed requirements to report infringements to the oversight function, it should be noted that in some cases the oversight function includes externals which could potentially introduce conflicts of interests.

As set out at the beginning of in the consultation paper, chapter '4 Reporting of infringements (Article 14 BMR)', "Article 14 of the BMR "Reporting of Infringements" provides for different obligations to enable the administrator to identify infringements, especially with regard to benchmark manipulation, and report them to the competent authority." Benchmark administrators will always strive to do the utmost to provide reliable and accurate benchmarks. To be able to do so, a benchmark administrator needs to screen the input data used to ensure its integrity. In this context, the BMR states that a benchmark administrator should be able to 'identify and report to the competent authority any conduct that may involve manipulation or attempted manipulation of a benchmark, under Regulation (EU) No 596/2014'. Notably, the BMR refers to manipulation or attempted manipulation of a benchmark. This means a manipulation or attempted manipulation of the benchmark itself. The benchmark administrator is thus to identify manipulation or attempted manipulation in the sphere of the benchmark administrator as the benchmark administrator can only perceive a manipulation or attempted manipulation in the sphere that it controls. This also follows from applying the proportionality principle to the benchmark administrator's obligations in the context of Article 14. A benchmark administrator can, however, not be expected to monitor all events (including manipulation or attempted manipulation) on the markets, e. g. Exchanges, which could ultimately and indirectly have an influence on the value of a benchmark. Benchmark administrators obtain data from other sources that corroborate the input data, they can e.g. compare the values received from vendors for the calculation of indices against public sources e.g. against data from APAs and information vendors. Benchmark administrators can e.g. monitor price jumps; prices after jumps are not used until data has been checked. However, benchmark administrators are not in a position to establish market surveillance processes which detect any potential input manipulation that could influence the calculation of an index. In this context, the information accessible to a benchmark administrator should be taken into account as benchmarks administrators only have access to data from vendors or publicly available data.

Q8 - Do you agree with the systems suggested for the surveillance of market manipulation? In particular, do you think that an automated system should be required only when it appears to be adequate according to the nature, scale and complexity of the benchmark? Please specify.

Please see the answer under Question 7.

Mandatory administration of a critical benchmark

Q9 - Do you think that other criteria should be considered in relation to the transition of the provision of the critical benchmark to a new administrator? Please specify.

N/A

Q10 - Do you think that other criteria should be considered in relation to the cessation of the provision of a critical benchmark? Please specify.

Paragraph 108a includes a statement that, “It is possible that even in cases where the critical benchmark is no longer representative of the underlying market, mandatory administration is necessary to ensure the cessation of the provision of the benchmark in an orderly fashion”.

We are strongly of the view that the BMR should not give a competent authority the power to require an administrator to publish a benchmark that is unrepresentative of the underlying market or economic reality the benchmark is intended to measure. Any such expansion of a competent authority’s powers would create significant reputational and litigation risks for an administrator and could result in market uncertainty and instability.

Non-significant benchmarks

Q11 - Do you agree with the criteria under which competent authorities may require changes to the compliance statement? Please specify.

FESE considers that non-significant benchmarks should be subject to a proportional approach. We share ESMA’s understanding that ‘changes (to the compliance statement)’ does not mean that NCAs could require administrators of non-significant benchmarks to apply the requirements which they have chosen not to comply with.

However, the proposed requirements for administrators of non-significant benchmarks to supply additional information regarding how they address requirements they have chosen to opt out of could potentially become a significant administrative burden for benchmarks administrators of benchmarks that have been deemed *non-significant*. Depending on how the provisions would be implemented, there is a risk that providing further details in the compliance statement may in fact be as burdensome as applying the actual requirements, in which case the proportional regime set out in the BMR would be of limited value.

Q12 - Do you agree with the criteria under which competent authorities may require changes to the control framework requirements? Please specify.

FESE considers that non-significant benchmarks should be subject to a proportional approach. Regarding the proposed criteria, it is worth reminding that non-significant benchmarks are deemed such following an assessment concluding that there would not be a significant or adverse impact were the benchmark no longer to be provided.

Moreover, recital 42 of the BMR states: “While non-significant benchmarks could still be vulnerable to manipulation, they are more easily substitutable, therefore transparency to users should be the main tool used for market participants to make informed choices about the benchmarks they consider appropriate for use.” Based on this it is worth considering whether non-significant benchmarks should be subject to requirements to outline their “exposure to the risk of business discontinuity”.