asifma

Growing Asia's Markets

9 August 2019

Mr Tilman Lueder
Head of Securities Markets Unit
DG FISMA, European Commission
Rue de Spa 2
1000 Bruxelles
Belgium

Dear Mr Lueder

As discussed in our previous letters to you in relation to the EU Benchmarks Regulation (**BMR**), ASIFMA and its members are deeply concerned about the impact of the BMR on the Asia-Pacific region.

We understand that the European Commission (**Commission**) is preparing to undertake a consultation process as part of its preparation of a report (pursuant to article 54(1)(b) of the BMR) for the European Parliament and the Council on the effectiveness of the authorisation, registration and supervision regime of administrators, and the appropriateness of the supervision of certain benchmarks by a Union body. In anticipation of the commencement of this consultation process, we wanted to set out some of our concerns regarding the effectiveness of the three avenues for registration available to benchmark administrators located outside of the EU (**Non-EU Administrators**) and the issues that have been encountered by administrators in grappling with each of these options, being equivalence, endorsement and recognition. We hope these observations are of assistance to the Commission in the design of its consultation process and in its preparation of its report to the Parliament and Council.

While we understand that the Commission has indicated that it does not intend to make any significant revisions to the rules under the BMR, ASIFMA is of the view that there are clear limits on the ability to resolve the significant challenges associated with recognition and endorsement through non-legislative reforms and additional regulatory guidance. In particular, and as discussed further below, the liability imposed on legal representatives (in relation to recognition applications) and endorsing agents (in the case of endorsement) has created a situation in which firms are reluctant to perform such roles other than at a cost which has proven uneconomical for even the major Non-EU Administrators. In light of this, we strongly encourage the European Commission to consider proposing amendments to the text of the BMR itself so to reduce the burden and cost for Non-EU Administrators. Further, although equivalence has presented itself as a more viable option for Non-EU Administrators, there still remain a number of issues which may present operational challenges, particularly in light of the upcoming discontinuation of LIBOR and the industry transition to alternative risk-free rates.

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Issues with endorsement

ASIFMA notes that, as at the date of this letter, only one Non-EU Administrator, S&P Dow Jones Indices LLC, has been endorsed under Article 33 and this was by its Dutch affiliate, S&P DJI Netherlands B.V.. It appears that no Non-EU Administrator has been endorsed by an independent third party endorsing agent. We believe that this is likely due to the significant obligations imposed on endorsing agents, including:

- verifying and demonstrating that the non-EU benchmark fulfils requirements at least as stringent as those set out in the BMR; and
- monitoring the activity of the provision of the non-EU benchmark.

Further, in addition to the above factors, which are likely to deter entities from acting as endorsing agent, we note the significant role which endorsing agents must play in the control and accountability framework of Non-EU Administrators seeking endorsement. This will deter Non-EU Administrators from pursuing this option, as they are likely to be reluctant to cede control over their activities to a third party.

As noted by ASIFMA in its previous reports on the BMR, endorsement is primarily only a feasible solution where Non-EU Administrators are part of a corporate group containing EU benchmark administrators or EU-supervised entities willing to act as endorsing agents. As such, only a small pool of Non-EU Administrators with the necessary corporate structure will consider endorsement a viable option for seeking registration.

Currently, there is no incentive for endorsing agents to take on external liabilities unless appropriately compensated. This in turn results in a significant endorsing fee for Non-EU Administrators which further deters Non-EU Administrators from pursuing endorsement. If the obligations for endorsing agents are reduced, this may translate into lower external liabilities and costs that are acceptable to both Non-EU Administrators and endorsing agents.

We are unable to include the specific details of costs associated with endorsement without compromising the confidentiality of our conversations with Non-EU Administrators. Nevertheless, any cost associated with engaging an endorsing agent, recognised in the EU, is likely to be prohibitive as the majority of Non-EU Administrators do not operate commercial business models, because they do not charge users of their benchmark a fee.

On this basis, ASIFMA recommends that the Commission consider reducing the obligations and corresponding costs imposed on endorsing agents under the BMR.

Issues with recognition

There are two inherent issues with the mechanism for recognition, as set out in article 34 of the BMR, which warrant amendment of this provision.

First, the significant responsibilities and liabilities which must be assumed by the legal representative have a clear impact on the viability of this avenue for registration. In October 2018, ASIFMA and Herbert Smith Freehills surveyed a number of Non-EU Administrators where a large number of Non-EU Administrators highlighted their difficulty in finding firms to act on their behalf as legal representatives. The responsibility and liability associated with this role has meant that those firms willing to perform such a function will

only do so at a significant price, which is not economical for smaller Non-EU Administrators, thereby preventing them from seeking registration of their benchmarks.

It should be noted that, as at the date of this letter, the only two Non-EU Administrators to have successfully obtained recognition for their benchmarks have done so by using another entity in their corporate group as their legal representative. Utilising another entity within their corporate group is not feasible for the majority of Non-EU Administrators, and in particular for those administrators which are not-for-profit industry bodies, due to the fact that they only operate in their domestic market and are not part of a group with international affiliates.

In its current form, article 34 is structured in such a way that favours large corporate global administrators to the unfair disadvantage of smaller Non-EU Administrators that lack comparable financial resources and a large corporate structure. Unless amended in a way that encourages more firms to act as legal representatives, article 34 will continue to have an anti-competitive effect by adversely affecting smaller administrators and preventing the continued use of their benchmarks in the EU.

Second, notwithstanding the scarcity of firms across the EU interested in acting as a legal representative, the continued requirement under article 34 to use a legal representative located in the Non-EU Administrator's Member State of Reference poses a further significant barrier to administrators. This reduces the pool of potential legal representatives even further, especially for those Non-EU Administrators with Member States of Reference located outside of the EU's major financial hubs.

ASIFMA recommends that legislative amendments to reduce the liability and responsibilities imposed on legal representatives should be made to significantly increase the viability of recognition for Non-EU Administrators. ASIFMA would also welcome clarification from the Commission as to whether the requirement to use a legal representative located in a Member State of Reference (rather than in any EU member state) still applies following the ESA review and the European Securities and Markets Authority's (**ESMA**) expanded role as the sole authorising body for Non-EU Administrators.

Issues with equivalence

ASIFMA and its members are supportive of the recent publication by the Commission of the equivalence decisions in respect of benchmarks in Australia and Singapore that are applicable to the administrators of benchmarks that are respectively declared as significant or identified as designated benchmarks.

However, we note that a number of the regulatory frameworks implemented in non-EU jurisdictions only cover a certain sub-set of the benchmarks provided in that jurisdiction (for example, systemically important interest rate benchmarks), and as such, an equivalence decision with respect to that jurisdiction may not cover all administrators in that jurisdiction. Similarly, jurisdictions such as Korea and India, which are currently in the process of implementing benchmarks legislation, have indicated that they intend to limit the scope of their regulatory oversight to a very small number of benchmarks considered by national regulators to be domestically significant. Non-EU Administrators face further difficulties in countries where multiple domestic regulators have jurisdiction over different types of benchmarks; for example, where equities benchmarks are supervised by a securities regulator and interest rate benchmarks are supervised by a banking regulator. These jurisdictions may require separate equivalence decisions covering the different categories of benchmarks. While we appreciate that the scope of third country legislative

regimes is a matter for third countries rather than the Commission, the narrow scope of these regimes does mean that it is crucial that recognition and endorsement are feasible options for those Non-EU Administrators which may fall outside of the scope of their national regimes.

ASIFMA also notes that, aside from alignment to the IOSCO 'Principles for Financial Benchmarks', it remains unclear from the Commission's draft equivalence decisions precisely how the Commission assesses equivalence. As such, it would be helpful if the Commission provided detailed guidance and transparency as to what criteria the Commission will use in determining whether the relevant legislation or regulation is equivalent to the BMR. This would be of significant assistance to third country regulators and legislators in designing domestic regimes and preparing applications for equivalence.

Supervision of benchmarks by a Union body

ASIFMA understands from the Commission's press release in relation to the ESA Review (MEMO/19/1928 dated 1 April 2019), that it is envisaged that ESMA will now be the sole authorising body for Non-EU Administrators.[1] However, the proposed amendments to the BMR will only apply from 1 January 2022, immediately after the expiration of the extended transition period. It would be helpful if, either as part of the report to the Parliament and Council or otherwise, ESMA and the Commission could provide further detail as to the anticipated role of ESMA in supervising non-EU benchmarks.

In particular, we note that, regardless of the ESA Review, article 30 of the BMR provides that a benchmark administrator may obtain registration as a result of the adoption of an implementing decision by the Commission as to the equivalence of a third country's legal framework and supervisory practice with the BMR. Following the outcome of the ESA review, there is uncertainty around the respective roles of the Commission and ESMA in the third country application and decision making process, and more guidance is required on how non-EU regulators should liaise between the two bodies.

Further, ESMA's letter to ASIFMA dated 28 May 2018 mentions that '*[u]nder this [endorsement] regime the BMR assigns no task to ESMA, and it is the relevant NCA that has the duty to assess the applications for endorsement against the criteria identified by the BMR*'. Further clarity is required as to whether this position will stand following the conclusion of the ESA review, particularly given the possibility that NCAs may take differing approaches to endorsement applications brought before them.

Scope of BMR

The scope of the BMR will pose a number of difficulties for Non-EU Administrators. ASIFMA and its members would greatly appreciate the Commission's consideration of these issues as part of its reporting process.

First, under article 3(16) of the BMR, 'financial instrument' is defined as one that is traded on a trading venue (**TOTV**), submitted to be TOTV, or traded by a Systematic Internaliser (**SI**), as set out in the Markets in Financial Instruments Directive (**MiFID II**) Directive 2014/65/EU. These MiFID-specific terms present difficulties to many Non-EU Administrators who are unfamiliar with this terminology when interpreting

[1] As per paragraph 52 of the amended proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority), dated 12 September 2018.

the meaning of 'financial instrument'. Further, the scope of financial instruments covered under the BMR is broader than those covered under the trading transparency requirements set out under MiFID II. The rationale for this inconsistency is unclear, and is one area in which further guidance from the Commission would be welcomed. Not only does this inconsistency risk creating confusion on the part of the market, but it raises more fundamental public policy questions as to the purpose of the wider scope of the BMR vis-à-vis MiFID II.

Further, we note that the inclusion of instruments traded by an SI within the definition of 'financial instruments' requiring registration under the BMR is practically unworkable. This is on the basis that market participants lack visibility as to whether an SI might have traded a particular instrument that is not TOTV.

ASIFMA and its members would welcome changes to align the BMR scope to the MiFID II pre-and-post trade transparency requirements for TOTV instruments. As such, we recommend that the reference to SI's be removed from the definition of 'financial instrument' contained within article 3(16) of the BMR.

More generally, we recommend that the Commission consider ways, such as a consideration of materiality, to mitigate the impact of the BMR on non-EU Benchmarks, including by re-examining the scope of the BMR as it applies to non-EU benchmarks. For example, granting exemptions to non-significant benchmarks, (i.e. where it is used as a reference for financial instruments or investment funds having a total average value of less than EUR 50 billion), issued outside of the EU would significantly reduce the impact of the BMR while not unduly affecting the investor protection objective of the BMR. ESMA is best placed to assess whether a benchmark is 'non-significant', given ESMA's unparalleled level of access to information regarding European trade volumes (and assuming that ESMA was willing to engage in dialogue with administrators as to whether their benchmarks were significant or not).

It has been suggested by the Commission and ESMA that firms that have already voluntarily registered as an SI for a class of derivatives should deregister in order to take certain financial instruments out of scope of the BMR. However, this fails to recognise that firms have taken this approach at the request of their European clients and to streamline the implementation of MiFID II. To reverse this process would be contrary to the policy objectives of MiFID II and in any event, would ultimately be redundant once the mandatory obligation for firms to register as an SI (for a far wider range of financial instruments than is currently required) is introduced.

Second, further clarity is needed on the impact of the BMR on buy-side supervised entities. In particular, there seems to be some inconsistency amongst national competent authorities (**NCAs**) as to what is meant by 'use in the Union' of a benchmark. For example, we understand that one NCA has interpreted the BMR Q&A 5.2 (d) narrowly, and as a result has suggested that EU counterparties to an OTC transaction would fall outside the scope of the BMR if they traded outside Europe with a non-European Economic Area counterparty. While ASIFMA considers this interpretation to be a helpful one, we would welcome a confirmation that this interpretation is shared by other European NCAs and can therefore be relied upon by all supervised entities irrespective of their country of incorporation. The current lack of clarity at the EU level contributes to the confusion on the impact of EU BMR outside of the Union.

Third, ASIFMA urges the Commission to consider taking a broad view of the term 'public authority' as defined in article 1(29) of the BMR. This would be of significant assistance to a number of benchmarks

issued across the Asia Pacific region which are issued by administrators which have traditionally had close engagement with central banks, and/or have been established specifically to assume the role of benchmark administrator from central banks and/or regulators. While these administrators currently fall outside the definition of 'public authority' on a strict interpretation of the current definition, we consider that these entities should be considered to perform a public service under the influence and oversight of, (if not the control of), a government body. As such, we encourage the Commission to issue guidance to that effect.

Finally, we continue to highlight that there are a number of restricted currencies across the Asia Pacific region. In certain jurisdictions, regulatory authorities do not recognise the offshore market which typically offers a more liquid and transparent market than the onshore market for market participants wishing to hedge their onshore exposure. If rates referencing those currencies do not receive registration under the BMR (and are therefore not able to be used within the EU), this will have a significant impact on EU investors and manufacturers whose only liquidity providers are European supervised entities, as there are no alternative benchmarks referencing these currencies. Furthermore, identifying alternative rates would be an imperfect solution as it would create an unhedgeable risk and could lead to potential political consequences as third-country authorities respond to pressure on their domestic policies.

We welcome the opportunity for continued engagement with the Commission on this issue. As set out in our earlier reports, if large numbers of APAC benchmark administrators are unable to obtain registration, markets globally and across the APAC region are likely to suffer a significant impact. This impact includes reducing the number of benchmarks in the region and denying EU firms, and potentially some of their affiliates, access to a large volume of financial instruments and contracts that reference non-EU benchmarks.

If you have further questions or would otherwise like to follow up, please contact John Ball, Managing Director, Global FX Division at jball@gfma.org or +852 2531 6512 or Matthew Chan, Executive Director, Head of Policy and Regulatory Affairs, at mchan@asifma.org or +852 6333 9767.

Sincerely,

Mark Austen
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ASIFMA