FESE position paper on the Benchmarks Regulation Review

Brussels, 22nd December 2023

1. Introduction

FESE welcomes the Commission's proposal to amend the Benchmarks Regulation (BMR) as regards its scope, use of benchmarks and certain reporting requirements. We believe that the proposal could - if further refined - positively contribute to addressing shortcomings in the current BMR, such as concerns about the compliance burden for benchmark administrators to offer their benchmarks in the EU. In this context, we commend the extension of the third-country regime transition period until the end of 2025 to allow third-country administrators to adapt to the provisions, while aiming to prevent any abrupt interruption of EU users' access to third-country benchmarks.

We endorse the proposal to reduce the scope to critical benchmarks, significant benchmarks, EU Climate Transition Benchmarks (CTBs) and EU Paris Aligned Benchmarks (PABs). However, for FESE it is imperative that any proposed framework does not compromise a level playing field between EU and third-country administrators. In this regard, FESE strongly cautions against the distortions of competition that would be introduced by the designation regime for significant benchmarks and the imposition of a location policy for endorsed or recognised third-country benchmark administrators willing to provide EU CTBs and PABs.

Therefore, while we find several of the suggested changes promising, we consider that certain aspects of the proposal could benefit from refinement to enhance clarity and calibrate level playing field considerations. These adjustments are consistent with the BMR review's goal of reducing the administrative and regulatory burdens imposed on EU and non-EU benchmark administrators as well as EU benchmark users, while ensuring continued investor access to the widest range of benchmarks that meet their needs.

2. Significant benchmarks

The current regulatory framework applied to non-significant benchmarks lacks proportionality. Many governance and control requirements should not apply to these benchmarks, which are less prone to manipulation. Limiting the scope down to the category of 'significant benchmarks' is, therefore, a proportionate approach that will reduce the burden on benchmarks without systematic risk, while allowing them to remain accessible to EU users.

Nonetheless, we wish to stress that, in order to establish a practical and predictable framework, the proposal would benefit from greater clarity regarding the category of 'significant benchmarks'. According to Article 24, these benchmarks can be defined based on either a quantitative threshold or a newly introduced designation-based system. In this respect, FESE suggests keeping the former as a stand-alone criterion. We firmly believe that a scope founded on clear quantitative thresholds would be much preferable as it would introduce simplicity and objectivity into the framework, while allowing benchmark administrators to anticipate the classification of benchmarks and determine their supervision status.

In particular, FESE supports the retention of the reference value of EUR 50 billion for significant benchmarks. However, it should be noted that the lack of clarity around the calculation of this threshold has been a long-standing issue that requires immediate resolution. The current text empowers the Commission to adopt Delegated Acts to further specify the calculation method, but action would be welcome as soon as possible.

On the other hand, we find that the introduction of a designation-based regime adds unnecessary complexity and uncertainty to the proposal. Granting designation powers to national authorities risks raising competition concerns, as this could lead to a situation where benchmarks of different administrators with similar characteristics end up unfairly subjected to different conditions across the EU. In addition, the conditions of substitutability and the risk of significant adverse impacts after cessation may be open to interpretation and lead to divergent approaches in the EU.

The consideration of ‘no, or very few, appropriate market-led substitutes’ could lead to different opinions. This is usually the case for regulated-data index providers whose offerings are based on publicly available regulated data, often shares of listed companies, and are easily replicable. However, whilst one might argue that indices seeking to cover the same underlying constituents can be deemed substitutable, the precise interpretation of the concept of substitutability remains uncertain.

In this context, would two indices identical in composition and methodology, but with two different brands, be considered substitutable? What about two indices targeting the same group of constituents but with different review periods, which may result in minor variations in the underlying companies? Would two indices be considered substitutable if, offered by different administrators, they track the same underlying companies but have a minor difference in the methodology? If these questions yield negative answers, the argument follows that no index can be deemed substitutable, rendering the criteria difficult to apply.

Furthermore, we are concerned that ‘more visible’ indices that would ‘matter greatly’ to a local economy would likely be designated as significant due to their frequent local use, while comparable and directly competing indices from other administrators, including EU but also non-EU-based administrators, potentially less used in that country, would not. This scenario, further favoured by the interpretative challenges in the substitutability concept, would create a direct unlevel playing field and unfairly distort competition.

This is especially the case for the above-mentioned indices based on regulated data which are easily replicable and are offered by EU and non-EU administrators. In order to promote a true level playing field and ensure that competing offerings can compete on a similar regulatory and supervisory basis, regulated-data benchmarks, as defined in Article 3(24), should be exempt from the qualitative designation process, limiting them to the scope of the quantitative threshold of EUR 50 billion.

In short, we believe the framework will be challenging to implement and we would strongly recommend narrowing the scope to objective quantifiable criteria, on the basis of the EUR 50 billion threshold, by removing Article 24(1)(b) from the proposal or, at least, exempting regulated-data benchmarks from the qualitative designation regime.

In the latter case, where the designation option would be maintained except for regulated-data benchmarks, all-encompassing powers of NCAs in the designation process should also be prevented. The coordinating role of ESMA should be strengthened for the sake of supervisory convergence. Finally, the criteria outlined under Article 24(3) should be further specified at level 2 by ESMA to ensure a common approach based on reasonable and objective criteria which favours equal treatment of similar benchmarks.

3. EU CTBs and PABs

FESE notes that the Commission has decided to keep EU Climate Transition Benchmarks (CTBs) and EU Paris-Aligned Benchmarks (PABs) within scope, regardless of their significance, but contingent upon obtaining authorisation or registration in the EU. This approach would introduce a *de facto* relocation requirement to the EU for third-country administrators who wish to offer EU CTBs and PABs, despite being recognised or endorsed. This raises concerns about an unlevel playing field for benchmarks depending on their location and overrides the investments made by third-country administrators to provide these benchmarks.

ESMA data show that over 90% of existing climate benchmarks are provided by administrators located outside the EU[1]. Instead of relocating to the EU, third-country administrators already offering EU CTBs and PABs may decide to terminate them, due to financial and administrative burdens arising from the relocation of the CTB/PAB business, and those administrators contemplating offering them would be incentivised not to do so. This would also be to the detriment of EU benchmark users, EU investors and the EU's sustainable financing ambitions. Commission analysis[2] estimates assets under management of financial products referencing CTBs or PABs at EUR 116 billion in 2023, with these labels recognised globally as 'solid tools' to tailor portfolios to a decarbonisation pathway. Preserving investor choice is crucial to continue positioning these benchmarks as market makers and in considering the various use cases for climate benchmarks. Alternatively, an eventual spin-off of EU CTBs and PABs to a newly set-up EU administrator would result in the split of a previously integrated business into two entities supervised by different regulatory authorities (ESMA and the NCA) and with a substantial outsourcing of activities to the parent administrator in the third country.

Considering these likely scenarios and their market impact, the proposed Article 19a(4) could undermine the coherence and efficiency of the overall supervisory regime, while increasing the cost of supervision. It would also significantly increase the complexity, administrative burden and costs of benchmark administrators' operations arising from the relocation of the CTB/PAB business, which could ultimately be passed on to EU benchmark users (i.e. more expensive underlying) and end-investors of ESG investment products in the EU (i.e. more expensive products). Further, the Commission would not have conducted an impact assessment of this proposal.

The Commission has argued that restricting the provision of EU CTBs and PABs to administrators authorised and registered in the EU is motivated by the need to "*safeguard the integrity and reputation of the associated EU labels*". In this context, FESE would appreciate further clarification as to why it is considered that third-country benchmark administrators cannot safeguard this integrity. FESE believes that EU ESG labels under the scope of the BMR should also be accessible for recognised or endorsed third-country administrators, provided they demonstrate compliance with all ESG label BMR requirements.

From a benchmark user perspective, and in the absence of changes to Article 19a(4), clear contingency provisions and procedures should be laid down regarding the determination of the final settlement price for index futures, i.e. in case of extraordinary circumstances. If the benchmark provider decides to cease or provide EU CTBs and PABs with a limited lifetime, benchmark users should not assume the risk calculation/decision processes on themselves in relation to the final settlement price on open interests.

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[1] ESMA, ESMA's response to the Commission's consultation on the BMR Review, August 2022, available here.

[2] European Commission, Q&A on the Sustainable Finance Package, June 2023, available here.

4. Others

Commodities

While we appreciate the approach finally chosen to reduce the BMR scope without a complete overhaul of the regulatory framework, we wish to make the case for a particular set of benchmarks, i.e. commodity benchmarks. The reduction in scope is particularly important for small commodity benchmarks that are not contributor-based. The current BMR text seems to negate the existence of commodity benchmarks within Annex II that are not contributor-based and subsequently only exempts small contributor-based commodity benchmarks (Article 2(2)(g)). Should legislators still decide that commodity benchmarks subject to Annex II should be maintained in the scope of BMR, it is crucial to reintroduce the small commodity benchmarks exemption and to ensure that all commodity benchmarks subject to Annex II can benefit from it (i.e. not contributor-based commodity benchmarks alone).

ESG diligence requirement

Another aspect to consider from the benchmark user perspective is the possible introduction of an ESG diligence requirement by co-legislators, whereby administrators of non-significant benchmarks no longer have to report ESG indicators, key elements of the methodology, in their benchmark statement and as part of the transparency of methodologies. While we appreciate the efforts to reduce the administrative burden on administrators, this initiative would merely shift the burden to benchmark users making ESG-related claims. In practical terms, verifying this information for each underlying benchmark used for their products is a very difficult task for users, which might even become repetitive as administrators' methodologies may evolve. It would be costly and time and resource-intensive for the benchmark user, who also does not have access to the full data set of contributors providing input data to a benchmark. For example, benchmark administrators have contractual relationships with ESG data providers to receive the data for their index calculation which benchmark users might not have. Currently, administrators perform this task only for their benchmarks, but users would need to go after each administrator associated with the benchmarks they use as underlying. Hence, we doubt that the overarching objective of reducing the overall administrative burden will be achieved and we ask co-legislators to reassess proposals moving in this direction.