Considerations in response to the Targeted Consultation on the Third Country Regime under the Benchmark Regulation

The Index Industry Association (IIA) welcomes the opportunity to submit feedback to the European Commission's targeted consultation on the functioning of the third country regime under the Benchmark Regulation (BMR), as well as comment on the functioning of other aspects of the BMR regime.

The IIA has actively contributed to the development of the BMR and supports the BMR's aims of transparent, robust, and reliable benchmarks. The IIA shares the view that robust and reliable benchmarks can play an essential role in the efforts to complete the EU Capital Markets Union. Benchmarks are used to provide retail investors and institutional end-users alike with low cost investment options, as well as for managing daily business activities, such as hedging risk. They are valuable tools for accessing previously inaccessible market segments, steady access to necessary pools of capital, and the continued use of certain benchmarks is a critical component of maintaining financial stability.

Firstly, the IIA would like to reiterate the need for a permanent solution for the use of third-country benchmarks by EU-supervised entities ("third country regime"), which would provide regulatory certainty to administrators and users alike.

It is worth noting that a well-functioning third country regime is inextricably linked to the scope of the BMR, an issue highlighted by the European Commission in the consultation paper.

The benchmark industry is a global industry, and as such, a well-functioning third-country regime is crucial for the continued and unhindered provision of benchmarks to EU end-users. A third-country regime that is not fit-for-purpose would restrict the ability of EU end users to access a wide range of benchmarks, putting them at a disadvantage compared to non-EU end users.
In order to have a well-functioning third country regime, one must first recalibrate the scope of the BMR and apply the founding principles that underpin it, which are the introduction of proportionality to "*avoid putting an excessive administrative burden on administrators…* [for benchmark] *which pose less threat to the wider financial system*"[1].

Nonetheless, we note that the third-country regime as currently structured is not fit-for-purpose. **As such, we would urge the European Commission to extend the transitional period until December 30th, 2025, in alignment with the respective extension granted in the UK.** This additional period would ensure the appropriate time to recalibrate elements of the third country regime and wider BMR that are currently not functioning, allowing for the market to adopt a permanent framework that is fit-for-purpose, in an orderly manner, and not disrupt the functioning of the market.

We would emphasize the following points, for the consideration of the European Commission, in the context of improving the third country regime and wider BMR framework:

[1] Recital 40 BMR

I. A systemic risk-based definition of strategic benchmarks

We note that the European Commission is considering the development of a new category of benchmarks, to be deemed "strategic". **The IIA would, in principle, support the determination of strategic benchmarks and then the subsequent restriction of the third-country regime to this category, which we consider should apply equally to strategic benchmarks made available by EU administrators.**

The determination should be primarily based on the **systemic nature of the benchmark,** which would deem it "strategic" from the perspective of its importance in the maintenance of financial stability. In this sense, these benchmarks should be considered as "systemic" rather than broadly "strategic".

Adopting the term 'strategic' may have unintended consequences and distort competition within the European market. Use of the word 'strategic' may give the impression of promoting specific interests and that the European Commission endorses specific benchmarks over others, which we do not believe is the intent of the European Commission.

We note that properly defining these benchmarks would, in certain circumstances, call for a divergence from the current "critical benchmark" definition, which includes non-systemic equity benchmarks, but we note the usefulness of the current risk-based approach to the determination of critical benchmarks in the existing BMR framework[i]. Equity benchmarks operate in a competitive market with many substitutes available to investors. Further, from a risk point of view, they have a low risk of being manipulated as they are constructed from regulated data. Finally, the provisions applying to critical benchmarks are not fit for purpose for equity benchmarks (i.e. mandatory contributions from exchanges would not be possible).

An important further consideration for the determination of this category should be **that** there be no substitutable benchmarks available (systemic benchmarks should not be able to be replaced by another). If multiple benchmarks are available, users have alternatives to consider if they desire or in case an issue arises.

In addition, the IIA recognises the centrality of the Climate-Transition and Paris-Aligned benchmark labels for the development and offer of investing solutions that are aligned with the sustainability preferences of end-investors. **Nonetheless, in the absence of the aforementioned considerations for the determination of systemic significance, these labels should not automatically lead to strategic designation.**

Finally, we would encourage the European Commission to consider **a transparent, and standardised designation process**, predicated on ongoing participation of all relevant stakeholders, including benchmark administrators.

II. Limitations in relation to the equivalence, endorsement and recognition options

Under the current third-country regime a supervised entity within the EU will not be able to use a benchmark provided by a third country administrator unless one of three alternatives apply. Each of these alternatives currently present significant limitations,

1) Equivalence

Several regulators have already expressed their reluctance to issue binding regulations, and existing regimes tend to only apply to a limited number of significant benchmarks, usually interest rate and FX benchmarks. In the absence of equivalent regimes which can satisfy the conditions for equal treatment, European investors will lose access to existing benchmarks that they have been commonly able to use until now. As IOSCO has noted, this eventuality may cause liquidity, contractual and market access issues, as well as concentration risks with regard to some benchmarks.

We encourage the European Commission to be in continuous contact with third-country regulators and respective NCAs in order to facilitate the future adoption of equivalence regimes.

2) Recognition

The recognition regime requires third-country administrators to appoint a legal representative that can be liable in case of breaches with the BMR. In the absence of an EU affiliate, this representative would be an unrelated third party. The oversight of the respective benchmark would then take place in conjunction with this third party, which may create competition issues and potentially raises questions of extra-territorial jurisdiction in relation to the third country administrator. The uncertain remit of responsibilities for both the legal representative and the third country administrator has restricted the success of recognition as a viable route for third country administrators. In addition, although the original and convoluted requirements to identify a member state of reference have been addressed the application process remains a burdensome and costly process.

The IIA would recommend for third-country administrators to demonstrate compliance with the IOSCO Principles to ESMA, in order for recognition to be granted. This approach would reduce the enormous administrative burden for both the European Commission and ESMA, in addition to benchmark administrators, under the current proposal.

3) Endorsement

For a third country administrator the endorsement route potentially involves several steps; first the establishment of an EU benchmark administrator, with sufficient local substance, and an application to an NCA to act as an authorised benchmark administrator. Subsequently, a second application to the NCA by the EU benchmark administrator to act as an endorsing administrator. If the third country administrator does not have the resources to establish an EU benchmark administrator, its only recourse is to approach an existing EU benchmark administrator, who will likely be a competitor. In a similar vein to the limitations of the recognition regime, this option would require an external EU benchmark administrator to endorse a specific benchmark, which raises competition, liability, governance and commercial concerns. This is especially the case considering the extent to which the governance and accountability of the endorser and the endorsee need to be intertwined. Even where the endorsing entity is part of the same group of companies, it increases the cost associated with the administration of the benchmark. As with recognition, it is difficult to see how the endorsement process could work effectively between unrelated entities due to access to commercially sensitive information, the power and control the endorsing administrator retains and the liability the endorsing administrator must bear.

We particularly note the risk of multiple layers of supervision. Concurrent supervision by ESMA, an NCA and, in some cases, a third-country supervisor may lead to unnecessary burden and confusion, including potentially contradictory requirements.

Finally, we would note that, inherent in the recognition and endorsement regimes is the approach of regulating at the level of the benchmark administrator, rather than at the benchmark. In line with our position for the future regime to be de-scoped to benchmarks that will be designated as strategic, we note that the future regime should call for regulation at the level of the designated benchmark, with no additional requirements set at the level of the administrator.

III. Ensuring the ESMA register is fit-for-purpose and aligned with the forthcoming European Single Access Point (ESAP)

The BMR introduced the creation of the ESMA register, which may provide transparency to both administrators and users of benchmarks. Nonetheless, we note a number of deficiencies in the current register framework, which should be revisited to ensure a robust third-country regime to function properly in the long-term. Notably, we consider that due to the large number of benchmarks and frequent changes, administrators should be required to publish and regularly update their own list, on their respective websites. This option would provide transparency to investors and avoid the complications arising from information technology-related issues, given the significant amount of data to be published/updated on a continuous basis. Further, it would solve the uneven coverage of third-country and EU benchmark administrators in the current framework, under which requirements for the former as significantly more cumbersome.

In addition, we note the potential inclusion of certain reporting requirements for benchmark administrators under the developing proposal for the ESAP. The IIA strongly supports the need for transparency, but would note the need of avoiding double reporting under the ESMA Register and the forthcoming ESAP. This could be avoided by ensuring ESMA be responsible for the provision of the relevant data under the ESAP framework.

IV. Caution in proceeding with an ESG benchmark label and the need for a clearer SFDR framework

ESG investing is increasing, with no signs of abating, and the IIA stands behind the European Sustainable Finance Agenda. The IIA's own ESG Survey[ii] found that 85% of surveyed fund-management companies consider ESG to be central in their decision-making, across both actively-managed funds and passive exchange-traded funds.. In the next 12 months, 40% of asset management portfolios are expected to include ESG elements (up 13 percentage points from the IIA's 2021 ESG survey). That projection grows to nearly six in ten (57%) of portfolios in 5 years (up 13 percentage points from 2021). In the next decade, respondents expect ESG elements to be incorporated into nearly two-thirds (64%) of their portfolios – a notable increase from 52% in 2021. As ESG investing continues to grow, the survey results reaffirm the supportive role that indexes play in ESG investment and benchmarking.

Index providers remain highly trusted by asset-management companies to drive progress in ESG investing. Nearly nine-in-ten respondents (89%) trust index providers a lot (45%) or somewhat (44%) to push financial services ESG innovation and standards – on par with Regulators and the asset management industry itself (both 91%). ESG benchmarks provide an essential reliability and transparency to the investment ecosystem, which is crucial in the face of evolving geopolitical events and an evolving regulatory framework.

We note the regulatory certainty that can be provided by well-calibrated labels for sustainable products, which may also be the case for benchmarks. **Nonetheless, even if these be voluntary labels, it is of crucial importance to the continued development of this market that innovation and growth not be stifled by prescriptive standards at this stage** – especially as those concern social and governance risk, for which less high-quality, quantifiable data is generally available.

In this regard, the IIA would not support that the future BMR review proposal would include a provision for ESG benchmarks subject to prescriptive minimum standards or a requirement that the benchmark administrator should be located in the EU. There is a risk that setting standards and requiring a homogenous view on what sustainability is will likely fail, especially for a global industry, and may be quite damaging to the market. Instead, the focus should be on ensuring that providers have clear and transparent methodologies.

The European Commission's priority should be the clarification of disclosure requirements under the Sustainable Finance Disclosures Regulation (SFDR), as well as a further consideration of the usefulness of extending a reformed SFDR to become the basis of well-calibrated labelling regime, which may offer predictability to asset managers.

Benchmark administrators are often under commercial pressure to opine on the suitability of specific benchmarks for funds which are disclosed under the SFDR framework, and the vague definition of what comprises a "sustainable investment" under Article 2(17) creates added uncertainty on how to manage these requests.

Market participants are searching for more explicit clarification concerning the alignment between the SFDR and the Low-Carbon Benchmark Regulation (LCBR), in a way that would increase the uptake and usefulness of the two LCBR labels.

The appropriate instrument through which both these issues may be addressed would be a review of the Level 1 text of the SFDR and relevant supervisory clarifications on the implementation of the LCBR.

[i] We would note the importance of due consideration on whether a threshold-based determination is useful, considering current limitations in this approach in the context of the designation of critical benchmarks.

[ii] https://www.indexindustry.org/wp-content/uploads/IIA-report-FINAL-7-27.pdf