

## Position of the European Financial Congress<sup>1</sup> in relation to the European Commission's consultation paper on the EU Benchmark Regulation<sup>2</sup>

### Methodology for preparing the answers

The answers were prepared in the following stages:

#### *Stage 1*

A group of experts from the Polish financial sector were invited to participate in the survey. They received the consultation document and the consultation questions. The experts were guaranteed anonymity.

#### *Stage 2*

Responses were obtained from experts representing:

- commercial banks,
- regulatory bodies,
- market infrastructure institutions,
- the academia.

#### *Stage 3*

The survey project coordinators from the European Financial Congress prepared a draft synthesis of opinions submitted by the experts. The draft synthesis was sent to the experts participating in the survey with the request to mark the passages that should be modified in the final position and to propose modifications and additions as well as marking the passages they did not agree with.

#### *Stage 4*

On the basis of the responses received, the final version of the European Financial Congress' answers was prepared.

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<sup>1</sup> European Financial Congress (EFC – [www.efcongress.com](http://www.efcongress.com)). The EFC is a think tank whose purpose is to promote debate on how to ensure the financial stability and sustainable development of the European Union and Poland.

<sup>2</sup> [https://ec.europa.eu/info/law/better-regulation/initiatives/finance-2019-benchmark-review/public-consultation\\_en](https://ec.europa.eu/info/law/better-regulation/initiatives/finance-2019-benchmark-review/public-consultation_en)

## Answers of the European Financial Congress to the consultation questions

### Question 1.

**To what extent do you think it could be useful for a competent authority to have broader powers to require the administrator to change the methodology of a critical benchmark?**

Please rate from 1 (not useful at all) to 5 (very useful)

**REPLY: 4**

*Please explain your reply to question 1:*

Giving a competent supervisory authority greater powers to cause revisions to critical benchmark methodologies would have a positive impact on the stability of financial markets. The current solutions enforce a five-year contribution period for critical benchmarks, but they do not provide for any meaningful intervention by the regulatory authority in the process of introducing changes to the benchmark determination methodology. This may pose a risk to the stability of the panel in the long run, especially if the panellists are unwilling to implement the changes proposed by the administrator with respect to the contribution manner and the method for benchmark calculation.

At the same time, it should be noted that it is the administrator who bears the main risk in the event of a significant change in methodology. Therefore, setting the scope of new, extended powers of supervisory authorities should be preceded by a thorough impact assessment carried out by a panel of independent experts. Conditions under which the regulatory authority can change the methodology should be clearly defined in the BMR. The scope of supervisory intervention in benchmark methodology should be precisely defined as well. Consideration should be given to limiting such corrective powers to formal guidance and approvals. The legislative amendment envisaged, if implemented, should account for the potential risk of civil litigation initiated by parties to financial contracts.

### Question 2.

**Do you consider that such corrective powers should apply to critical benchmarks at all stages in their existence or should these powers be confined to:**

**a) situations when a contributor notifies its intention to cease contributions?**

**REPLY: Yes**

**b) situations in which mandatory administration and/or contributions of a critical benchmark are triggered?**

**REPLY: Yes**

*Please explain your reply to question 2a) and 2b):*

The question is worded in a manner which risks that the respondent's reply may be misunderstood ("yes" and "no" may mean the same). The answer "YES" means that the powers should be extended, but at the same time should be limited to the two cases mentioned. Those powers should not, however, cover 'all stages'. Therefore, the comment below is of key importance.

Powers of a competent authority to change the methodology for determining a critical benchmark should only apply to situations which are of particular importance to the stability of financial markets. In this context, in situations where the continued publication of a critical benchmark is at risk, the supervisory authority should have full powers to force a change in methodology and to force the further publication of a critical benchmark which is no longer representative. In both these situations, the competent authority's actions will serve to stabilise

the financial market. On the one hand, such powers would mean support for the administrators from the competent authority. On the other hand, the regulatory authority's intervention may prove important in order to ensure the stability of the financial market in a scenario where administrators are unwilling to significantly change benchmarks of their own volition. At the same time, where a panellist wishes to leave the panel, action should be taken where this affects the benchmark's representativeness. As a result, the relevance of the contributor in question for the determination of the benchmark must be analysed on a case-by-case basis.

**Question 3.**

**Are there any other changes to Article 23(6)(d) BMR relative to the change of methodology for critical benchmarks that might be desirable to improve the robustness, reliability or representativeness of the benchmark?**

**REPLY: Yes**

*Please explain your reply to question 3:*

A mechanism ensuring support by the supervisory authority for the administrator and for panellist banks should be put in place. Mere obligation without support may make implementing changes too costly, and fulfilling the supervisory authority's demands may become impossible. Support should consist in agreeing the optimal method and incentive scheme for panellist banks to compensate them for increased regulatory and economic risks, particularly with respect to the fees for using the benchmark.

**Question 4.**

**To what extent do you think that benchmark cessation plans should be approved by national competent regulators?**

Please rate from 1 (completely disagree) to 5 (fully agree)

**REPLY: 5**

*Please explain your reply to question 4:*

A contingency plan in the event that the publication of a critical benchmark is discontinued should be approved by the local supervisory authority, since these authorities have specialist knowledge of local financial market conditions. In particular, supervisory approval of the plan should involve an analysis of the potential impact of the publication of the benchmark in question being discontinued on the financial market. Such a measure will have a positive impact on improving the quality and reliability of contingency plans. As a result, approval of benchmark cessation plans may contribute to ensuring the continuity of benchmarks, and consequently also to ensuring the continuity of instruments which use the benchmark in question. This would serve both the interests of consumers, who are benchmark recipients, and the stability of the financial system.

**Question 5.**

**Do you consider that supervised entities should draw up contingency plans to cover instances where a critical benchmark ceases to be representative of its underlying market?**

**REPLY: Yes**

*Please explain your reply to question 5:*

Supervised entities should draw up contingency plans to cover cases where a critical benchmark ceases to be representative, since these plans are an essential element of mitigating compliance and economic risk for all supervised entities. Developing internal response mechanisms in case where the benchmark ceases to be representative will improve the security and stability of the transactions based on this benchmark and consequently will reduce the risk of disruption to financial markets. The drawing up of contingency plans should be combined with the

requirement to conduct annual reviews of the representativeness of benchmarks and (additionally) of the premises for their use in financial instruments on the part of supervised entities. The inclusion of a competent supervisory authority in the process of drawing up contingency plans should be considered as well, because potential risks may arise from divergence in the supervised entities' assessment whether the benchmark properly reflects the underlying market and whether a contingency plan should be implemented.

#### **Question 6.**

**To what extent do you consider the system of supervision by colleges as currently existing appropriate for the supervision of critical benchmarks?**

Please rate from 1 (not appropriate at all) to 5 (very appropriate)

**REPLY: 5**

*Please explain your reply to question 6:*

Colleges as a system of supervision are a good solution which ensures sound management, control and independence. Colleges are also a mechanism which enables better understanding between supervisory authorities (educational value) and the harmonisation of national solutions. However, establishing exact criteria for the host country's supervisory authorities' participation in the colleges should be considered. The current wording of Article 46(3) of the BMR is imprecise. Such a condition could be, for instance, linked to the value of financial instruments related to the benchmark in question.

#### **Question 7.**

**Do you consider that it is currently unclear whether a competent authority has the powers to withdraw or suspend the authorisation or registration of an administrator in respect of one or more benchmarks only?**

Please rate from 1 (very unclear) to 5 (very clear)

**REPLY: 3**

*Please explain your reply to question 7:*

A weakness of current BMR provisions is that the process for withdrawing both the administrators and the benchmarks (or families of benchmarks) created by them is not clearly regulated. The mechanism for suspending benchmarks is not consistent with the mechanism for administrator authorisation (or registration). The current provisions also do not clarify whether a competent authority may withdraw the authorisation to administer selected benchmarks among all those administered by the entity in question. Thus, regulations should clearly separate obtaining an administrator's licence and obtaining a licence (registration) for the development of specific benchmarks.

#### **Question 8.**

**Do you consider that the current powers of NCAs to allow the continued provision and use in existing contracts for a benchmark for which the authorisation has been suspended are sufficient?**

Please rate from 1 (totally insufficient) to 5 (totally sufficient)

**REPLY: 2**

*Please explain your reply to question 8:*

Powers of supervisory authorities to allow the continued use of a benchmark that has ceased to be representative may pose a threat to the stability and transparency of financial markets. Measures should focus primarily on motivating corrective actions or actions aimed at replacing the withdrawn benchmark. The mechanism of temporary consent for the use of a benchmark that is no longer representative (e.g. zombie IBOR) or does not exist is an attempt to maintain a status

quo that has no economic basis and may prove to be a solution which perpetuates bad practices in the financial market.

**Question 9.**

**Do you consider that the power of competent authorities to permit continued use of a benchmark when cessation of that benchmark would result in contract frustration are appropriate?**

Please rate from 1 (not appropriate at all) to 5 (very appropriate)

**REPLY: 3**

*Please explain your reply to question 9:*

Competent supervisory authorities must have powers to permit the continued use of a benchmark. However, these powers should only be applicable where there are actual risks to the stability of the financial market, as it should be remembered that the solution described here may be a short-term one. In addition, market confidence in supervisory support in critical situations may create moral hazard manifesting itself as reluctance to take corrective action or to introduce changes to the benchmarks used. In this context, supervisory permit for the continued use of a benchmark should be preceded by an attempt to restructure the relevant transactions.

**Question 10.**

**Do you consider that the regulatory framework applying to non-significant benchmarks is adequately calibrated?**

Please rate from 1 (not well calibrated at all) to 5 (completely adequately calibrated)

**REPLY: 3**

*Which adjustments would you recommend?:*

Reducing regulatory requirements for administrators of non-significant benchmarks is the right approach. According to BMR provisions, transparency to users should be the main tool used for market participants to make choices about such benchmarks.

However, regulations concerning non-significant benchmarks should also take into account the possibility of creating interest rate benchmarks with that status. The current regulatory framework is not conducive to the creation of new interest rate benchmarks in accordance with IOSCO and FSB recommendations. An additional problem is the need to clarify the principle of proportionality for benchmarks generated in a fully automated manner from transaction data in the OTC market. These benchmarks do not create risks specific to those which are based on expert judgment, but nevertheless need to meet certain regulatory criteria linked to that judgment.

**Question 11.**

**Do you consider quantitative thresholds to be appropriate tools for the establishment of categories of benchmarks (non-significant, significant, critical benchmarks).**

Please rate from 1 (not appropriate at all) to 5 (completely appropriate)

**REPLY: 4**

*Please explain your reply to question 11. If applicable, which alternative methodology or combination of methodologies would you favour?*

Quantitative thresholds are a good solution because they take into account the key parameter from the point of view of financial market stability, which is the volume of transactions based on the benchmark in question. However, qualitative considerations should be taken into account as well when establishing categories of benchmarks. Quantitative and qualitative criteria should apply to all benchmark classification levels. Additionally, the criteria adopted should depend on the market to which they are applied. Therefore, local supervisory activities should be actively involved in establishing categories of benchmarks.

**Question 12.**

**Do you consider the calculation method used to determine the thresholds for significant and critical benchmarks remains appropriate?**

Please rate from 1 (not appropriate at all) to 5 (completely appropriate)

**REPLY: 4**

*Please explain your reply to question 12. If applicable, please explain why and which alternatives you would consider more appropriate?*

The value of financial instruments or financial contracts related to a given benchmark as determined for the purposes of quantitative thresholds should include off-balance-sheet derivative exposures. In justified cases, local supervisory authorities should also be able to adjust quantitative thresholds. An obligation should also be introduced for users to report the volumes to which they apply benchmarks with respect to all types of benchmarks, including alternative ones.

**Question 13.**

**Would you consider an alternative approach appropriate for certain types of benchmarks that are less prone to manipulation?**

Please rate from 1 (not appropriate at all) to 5 (completely appropriate)

**REPLY: 3**

*If you would consider an alternative approach appropriate for certain types of benchmarks that are less prone to manipulation, please explain for which types:*

Interest rate benchmarks which represent the cost of financing exclusively on the basis of deposit transactions concluded, which transactions are automatically submitted from the systems of banks included in the panel.

*Please explain your reply to question 13:*

Benchmarks which are solely transaction-based should take precedence over other benchmarks. This applies in particular to interest rate benchmarks. Currently, all interest rate benchmarks are treated as if they were based on expert judgment with a high risk of manipulation and a significant volume of related instruments. This approach hinders the development of new alternative benchmarks in accordance with the provisions of Article 28(2) BMR.

**Question 14.**

**To what extent are you satisfied with your overall experience with the ESMA register for benchmarks and administrators?**

Please rate from 1 (not satisfied at all) to 5 (completely satisfied)

**REPLY: 3**

*Please explain your reply to question 14:*

The fact that the register only includes a list of administrators without a list of benchmarks significantly reduces the transparency of the information contained therein.

*If you are not satisfied with your overall experience with the ESMA register for benchmarks and administrators, please explain how could the register be improved:*

In order to increase register transparency and functionality, it should include a list of benchmarks alongside a list of administrators. The register should be extended to include information on the significance level of the benchmark in question and the date on which the administrator/benchmark was entered in the ESMA register.

**Question 15.**

**Do you consider that, for administrators authorised or registered in the EU, the register should list benchmarks instead of/in addition to administrators?**

Please rate from 1 (completely disagree) to 5 (fully agree)

**REPLY: 5**

*Please explain your reply to question 15:*

For security reasons, the register should contain information both on administrators and benchmarks. This would increase transparency of the information contained therein. It would also contribute to mitigating the risk of fraud consisting in a registered administrator developing unrepresentative benchmarks.

**Question 16.**

**In your experience, how useful do you find the benchmark statement?**

Please rate from 1 (not useful at all) to 5 (very useful)

**REPLY: 5**

*Please explain your reply to question 16:*

The benchmark statement properly discloses how the benchmark represents the *economic reality* it is meant to measure and the risks for its users. However, the level of detail of the information included in the benchmark statement should be more harmonised, as should be the methodology for describing the economic reality that the benchmark reflects.

**Question 17.**

**How could the format and the content of the benchmark statement be further improved?**

Measures could be taken to improve the comparability of benchmark statements. In this context, a more detailed specification of requirements concerning the contents of benchmark statements should be considered.

**Question 18.**

**Do you consider that the option to publish the benchmark statement at benchmark level and at family level should be maintained?**

Please rate from 1 (should definitely be removed) to 5 (should definitely be maintained)

**REPLY: 5**

*Please explain your reply to question 18:*

Given the strong links between the benchmarks published within families of benchmarks, the current approach is effective for both the administrator and for the users. This solution makes it easier to understand the nature of benchmarks.

**Question 19.**

**Do you consider that competent authorities should have explicit powers to verify:**

**a) whether the chosen climate-related benchmark complies with the requirement of the Regulation?**

Please rate from 1 (completely disagree) to 5 (fully agree)

**REPLY: No opinion**

**b) whether the investment strategy referencing this index aligns with the chosen benchmark?**

Please rate from 1 (completely disagree) to 5 (fully agree)

**REPLY: No opinion**

*(Please explain your reply to question 19 a) and 19 b))*

Climate-related benchmarks are an important element of sustainable financing. Therefore, it is clear that this category of benchmarks should be fully developed, including in the context of the supervisory process. A basic verification of climate-related benchmarks may be required to meet fiduciary duties. It may also be useful to check whether the investment strategy aligns with the chosen benchmark. However, the regulatory authority's potentially limited knowledge and resources in this area should be taken into account.

**Question 20.**

**Do you consider that competent authorities should have explicit powers to prevent supervised entities from referencing a climate-related benchmark, if such benchmark does not respect the rules applicable to climate-related benchmarks or of the investment strategy referencing the climate-related benchmark is not aligned with the reference benchmark?**

Please rate from 1 (completely disagree) to 5 (fully agree)

**REPLY: No opinion**

*(Please explain your reply to question 20):*

Such powers may be useful in the context of the preventive function. However, it is important that they be used only in extraordinary situations.

**Question 21.**

**Do you consider the current conditions under which a commodity benchmark is subject to the requirements in Title II of the BMR are appropriate?**

Please rate from 1 (not appropriate at all) to 5 (completely appropriate)

**REPLY: No opinion**

**Question 22.**

**Do you consider that the compound de minimis threshold for commodity benchmarks is appropriately set?**

Please rate from 1 (not appropriate at all) to 5 (completely appropriate)

**REPLY: No opinion**

**Question 23.**

**To what extent would the potential issues in relation to FX forwards affect you?**

Please rate from 1 (not at all) to 5 (very much)

**REPLY: 2**

**Question 24.**

**What improvements in the procedures do you recommend?**

- Clarifying the process for the recognition of administrators.
- NDF contracts concluded for currencies governed by foreign exchange laws which are not liberal are quoted at a level different than the local market and have no connection to the local money market. Thus, the classical interest rate parity is not maintained and the divergence between forward curves cannot be arbitrated because market segmentation prevents full interaction between residents and non-residents. Therefore, the link to the spot market may not be appropriate (in cases where the NDF in question is settled in a foreign currency without local currency flows and parties to the contract do not have full access to the local market, multiple foreign exchange rates may be present). Therefore, liberalising the approach to this market would be preferable in view of the high share of professional participants in the wholesale market and limited consumer exposure. The MIFIR/MIFID2 rather than the BMR should be used to safeguard the consumers' rights.