

Position of the European Financial Congress¹ in relation to the European Securities and Markets Authority's consultation paper on non-significant benchmarks²

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 selected extracts of the ESMA's consultation paper and the consultation questions in Polish. The experts were guaranteed anonymity.

Stage 2

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 3

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

¹ European Financial Congress (EFC – www.efcongress.com). The purpose of the EFC is to promote debate on how to ensure the financial security and sustainable development of the European Union and Poland.

² https://www.esma.europa.eu/sites/default/files/library/esma70-145-105_consultation_paper_on_draft_guidelines_on_non-significant_benchmarks.pdf

Answers of the European Financial Congress to the consultation questions

Q1: Do you have any views on the content of the draft guidelines on the oversight function for administrators of non-significant benchmarks? Would you suggest to include any additional elements or to delete one or more of the elements proposed?

The proposal to allow to have the oversight function for non-significant benchmarks performed by individuals hired or appointed by the administrator or its owner is beneficial to administrators generating indices with a low impact on the financial system. This would allow costs to be reduced with respect to direct internal oversight over the benchmark, enabling (i) indices to be maintained with a low nominal amount of linked transactions and (ii) new benchmarks to be created in accordance with the FSB's recommendations on the need for bottom-up initiatives looking for new indices (and families of indices) representative of new or evolving market segments. On the other hand, the requirement to have an oversight function in place in the light of Article 5(1) BMR for non-significant benchmarks is in itself understandable and acceptable.

The introduction of specific provisions (such as 4d) could anyway prove inappropriate in relation to the market/economic realities in terms of costs and organisation.

It seems that the design of the oversight function should be analysed on a case-by-case basis in the context of a specific market situation, instrument and economic reality.

Q2: Do you have any views on the content of the draft guidelines on input data for administrators of non-significant benchmarks? Would you suggest to include any additional elements or to delete one or more of the elements proposed?

The guidelines on input data should include requirements relating to the following areas:

- (i) data collection and verification (analysis and registers for rejected data, procedures for modified data to avoid manipulation, including with respect to transaction data);
- (ii) periodic ex post and cross-verification processes;
- (iii) obligating contributors to communicate efficiently with the administrator (in order to ensure quick feedback on outliers and provide for immediate improvement before the cut-off time for index publication);

- (iv) introducing a recommendation for administrators to enter into long-term contribution agreements – to ensure the stability of the data pool for the calculation of the benchmark.

Q3: Do you think the proposal to include in the guidelines a requirement for the three levels of control functions is appropriate for administrators of non-significant benchmarks?

The proposal presented in the guidelines is good. In particular where the current and expected field of application (use) of the benchmark is ‘socially relevant’. It should be the general rule that the intensity of controls and transparency should be correlated with the intensity of use of the benchmark concerned in long-term contracts, in particular those used in retail products.

Control on the contributor side significantly reduces the likelihood of errors compromising the consistency of the data sets used for calculating the benchmark.

Q4: Do you agree with the content of the draft guidelines on the transparency of the methodology for administrators of non-significant benchmarks? Would you suggest to include any additional elements or to delete one or more of the elements proposed?

The list of requirements is generally complete. However, it is worth considering whether the point concerning solutions to be provided in the case of insufficient reference market liquidity (1i) should be extended to cover cascading procedures showing the way to proceed in the event that there are no transactions or they are insufficient (or there are not enough contributors).

Q5: Do you think the proposal to include in the guidelines a requirement for publishing or making available to the public “a description of specific events that may give rise to an internal review including any mechanism used by the administrator to determine whether the methodology is traceable and verifiable” is appropriate for administrator of non-significant benchmarks?

The proposal concerning the line of action is appropriate. A higher degree of detail could be contemplated for the requirements (such as more specific actions to be taken by the administrator to ensure integrity). However, this could have an appreciable effect on the costs of the benchmark production process.

Q6: Do you agree with the content of the draft guidelines on governance and control requirements for supervised contributors to non-significant benchmarks? Would you suggest to include any additional elements or to delete one or more of the elements proposed?

Most probably, the design of the guidelines assumes (internal assumption) that benchmark administrators always use data that has already been processed by data contributors (such as weighted average transaction prices, pricing models, expert assessments, etc.). The regulation should expressly provide that where the administrator relies on basic data relating to transactions made by contributors (raw data), the requirements for verification, substitution etc. should be less stringent. It is essential that the administrator seeks to obtain input data (raw data).

For processes where (on the contributor side) data is generated automatically, the procedure presented in the guidelines seems to be too complex in relation to the expected risks. In the case of benchmarks based on transaction data clouds, it would be advisable to monitor the accuracy (before submission) and integrity (after submission) of transaction data in order to avoid misleading signals and to prevent manipulation.

Additionally, a front-running detection procedure should be applied to benchmarks covering a narrow time window instead of a whole business day.

Q7: Do you think that the proposal to include in the guidelines a requirement of establishing, where appropriate, a physical separation of submitters from other employees of the supervised contributor is suitable also for supervised contributors to non-significant benchmarks?

The obligation to physically separate submitters from other employees generates unnecessary costs for contributors, as control procedures would suffice in this respect.

Data contributors for non-significant benchmarks would be encouraged to contribute to the benchmark and then to apply it due to the low cost of creating it, and/or having identified it as a potential benchmark with a growing importance in the benchmark landscape. Therefore, a 'business' decision should be taken by the benchmark administrator to identify the extent to which the highest-scale measures should be taken to mitigate the risk of manipulation.

A good solution is to produce alerts on the basis of parameters (GL 8.3, point 2b), which would support data integrity and consistency.

Q8: Other comments on the content of the draft guidelines:

1) It is unclear whether the RTS or the Guidelines could be applied in the context of the BMR provisions (Article 18, the application of Articles 24, 25, 26 is excluded for interest rate benchmarks, concerning *inter alia* the exemption from the obligation to prepare benchmarks and data), as the context of the BMR puts interest rate benchmarks in a specific position where essentially the same and equally high data compilation and submission standards must be followed. The key guidelines on interest rate benchmarks are provided in BMR Annex I, and therefore it is most likely that the RTS and the Guidelines cannot be applied to interest rate benchmarks.

2) The cost-benefit analysis contains several important gaps.

- p. 37 – while it is true that the incremental costs of supervision will be borne by benchmark administrators, given that even a non-significant benchmark will have (might have) a significant share in oversight costs, the economic rationality of maintaining the benchmark could give rise to the need to abolish it.
- p. 38 – additional requirements imposed on data contributors to non-significant indices would also have a considerable impact on the economics and rationality of maintaining the benchmark.

Furthermore, the analysis on page 40 contains a claim that cannot be regarded as correctly diagnosed/described (“The incremental costs of these draft Guidelines for supervised contributors are minimal for two main reasons:[...]”). While a marginal increase in the costs of supervised data contributors could indeed be minimal, it has to be borne in mind that in general, the cost of data verification enforced by the BMR or RTS inflates the annual costs of contributors to the order of millions of US dollars/euros. It means that there is a strong negative incentive not to play the role of a contributor. Thus, not only could it prove difficult to maintain a stable group of data panelists for existing benchmarks, but it might also be impossible to create new benchmarks. This is actually inconsistent with the intention of regulators (the FSB, IOSCO) to encourage market actors to create new benchmarks. This applies in particular to interest rate benchmarks which generally have no regulatory enablers even in the case of the non-significant status (see Article 18 BMR).