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Re: Proposed EU Benchmark Regulation-extraterritorial concerns on equivalence

On behalf of the undersigned organisations, we write to express our strong concern on the potential negative impact of the equivalence regime of the EU's proposed benchmark regulation (the "Proposed Regulation"). Article 20 of the Proposed Regulation permits benchmarks provided by an administrator established in a third country to be used by supervised entities in the Union only if the European Commission recognises the legal framework and supervisory practice of that third country as equivalent to the requirements of the Proposed Regulation. We believe that such an equivalence regime, and the

envisioned transition timeline, risks creating confusion and uncertainty in global markets resulting in higher volatility and lower liquidity. Furthermore, the inability to access and utilise a diverse universe of global benchmarks could unnecessarily and adversely impact EU and non-EU financial institutions, investors and consumers as such constraints impact cross border capital flows and the availability of important financial products. In light of this, we suggest that the approach be modified to reflect market practicalities and risks, and any equivalence determination be assessed solely in relation to compliance with the International Organisation of Securities Commissions (IOSCO) principles.

Having said this, we would like to express our support for the work of the European institutions and authorities, including the European Commission, the European Parliament, the Council of Ministers, the European Securities and Markets Authority (ESMA), and the European Banking Authority (EBA) in developing frameworks of principles and regulation for benchmarks used extensively in financial markets. While we consider that benchmark innovation, production and distribution should remain industry-driven activities, we believe that IOSCO's internationally-agreed best practice standards, supported by the local or regional regulatory framework, are critical to promoting both investor confidence and the integrity of global financial markets. Our comments below are singularly focused on the equivalence regime (Art. 20), the IOSCO principles, and consequences and considerations for a more practical approach consistent with G20 principles and commitments, which calls on national authorities to implement global standards consistently, in a way that ensures a level playing field and avoids fragmentation of markets, protectionism and regulatory arbitrage.

Equivalence regime (Art. 20) and IOSCO principles

We are supportive of the international Principles for Financial Benchmarks published by the IOSCO in July 2013 and we believe that recognition of a third country administrator should be based solely on an administrator's conformance with the IOSCO principles. Article 20[1] of the Proposed Regulation, however, conditions an equivalence determination not solely based on IOSCO Principles but rather on the European Commission's adoption of an equivalence decision in accordance with paragraph 2, recognising the legal framework and supervisory practice of that third country as equivalent to the requirement of this Regulation. In this regard, paragraph 2 requires that: (a) administrators authorised or registered in that third country comply with binding requirements which are equivalent to the requirements resulting from this Regulation, in particular taking into account if the legal framework and supervisory practice of a third country ensures compliance with the IOSCO principles on financial benchmarks published on 17 July 2013; and (b) the binding requirements are subject to effective supervision and enforcement on an on-going basis in that third country. We believe that the IOSCO principles should be the overarching international standard and the Proposed Regulation should be amended to eliminate any equivalence comparison to the Proposed Regulation itself and rather should solely rely on the application of the IOSCO principles.

[1] Article 20 of the Proposed Regulation includes the following conditions for the use of third country benchmarks: (a) the Commission has adopted an equivalence decision in accordance with paragraph 2, recognising the legal framework and supervisory practice of that third country as equivalent to the requirements of this Regulation; (b) the administrator is authorised or registered in, and is subject to supervision in that third country; (c) the administrator has notified ESMA of its consent that its actual or prospective benchmarks may be used by supervised entities in the Union, the list of the benchmarks which may be used in the Union and the competent authority responsible for its supervision in the third country; (d) the administrator is duly registered under Article 21; and (e) the cooperation arrangements referred to in paragraph 3 of this Article are operational.

Article 39.1 of the Proposed Regulation requires an EU administrator providing a benchmark on the date of entry into force of the Proposed Regulation to apply for authorisation under Article 23 within 24 months after the date of application. Article 20 provides conditions for an equivalence determination for third countries and Article 21 provides for a registration process of third country administrators whose home state has received an equivalence determination. However, neither Article 20 nor 21 provide a transitional period for a third country to work through this process. Article 41 indicates that the Proposed Regulation shall apply from 12 months after entry into force and thus it seems that EU administrators are given a total of 36 months to register after the Proposed Regulation's entry into force. At a minimum, we believe the Proposed Regulation needs to provide for a similar, if not longer, transitional framework for third country administrators. Users of benchmarks should also be explicitly provided a transitional framework, beyond the parameters of Article 39.3 and 39.4, to mirror the transition to registration or authorization of the referenced benchmark.

We are greatly concerned that even a 36-month maximum timeline for both the equivalence determination and related registration would fail to recognize that while several third countries have established regulation for certain critical benchmarks, we are not aware of any third country that has proposed regulation with the wide scope envisioned by the Proposed Regulation[2]. Accordingly, it is unreasonable to expect that the regulatory and supervisory framework in many third countries will be fully in place to achieve an equivalence determination with the required cooperation arrangements within 36 months given the long lead time required based on the political and regulatory structure in individual third countries.

We believe the Proposed Regulation needs to recognize this fact and anticipate and provide for a longer transition period and alternative means for the recognition of a third country administrator within the EU. We believe the Proposed Regulation should permit third country critical benchmarks to register for authorisation directly with the Commission or ESMA regardless of the state of the local regulation in that third country so long as the administrator complies with the IOSCO Principles and provides evidence thereof. We also suggest that a tiered approach be considered where only critical benchmarks would be subject to the Proposed Regulation within an initial 36-month transition period. For example, any non-critical benchmark administrators that are within the scope of the final regulation could then be given an additional 24 months to register if their home country has achieved an equivalence determination. Lastly, we also believe the full transitional framework envisioned in Article 39.2-4 for existing EU benchmarks that do not meet the requirements of the Proposed Regulation needs to be explicitly extended to include third country benchmarks to similarly avoid contract frustration and forced asset sales.

Consequences

Since no third country jurisdictions currently appear to be pursuing broad based regulation of benchmarks, it seems unlikely that most third country benchmarks will be able to achieve an equivalence determination in time to meet the registration deadlines in the proposed EU regulation. We are therefore concerned that the expected prohibitions on the use and availability of those third country benchmarks by EU banks, investment firms, insurers and corporations may create significant and damaging market dislocations. The withdrawal of liquidity in products referencing such unregistered third country benchmarks at the same time as investors are compelled to sell related assets could damage confidence in our markets and disrupt important global capital flows with the EU. The lack of access to key global benchmarks could in turn impair the ability of EU financial institutions and investors to effectively

[2] For more details, please refer to the ISDA document: 'Benchmarks: Third-country initiatives in light of the EU benchmarks proposal (click here)'

manage and diversify global risks. As a result, the restrictions on benchmarks may make it harder for EU financial institutions to compete and participate in global markets which could diminish the market integrity and confidence that the Proposed Regulation seeks to fortify.

Conclusion

We suggest the Commission reconsider the approach taken in the Proposed Regulation regarding the recognition of third country benchmarks. We recognise and support the Commission's desire to protect investors and the integrity of financial markets. We, however, believe that more realistic and practical timelines and methods of oversight can achieve those objectives while avoiding fragmentation of our global markets and other unintended consequences for financial market participants.

Our comments here should also be considered in the context of the broader pursuit of coordinated international regulation. IOSCO is carrying out the G20 mandate to improve global financial stability and promote transparency of the global securities markets, an important part of which is to address challenges in achieving effective and workable cross-border regulation. Progress on this work will be considered at the upcoming G20 meetings of Finance Ministers in 2014. It is important that the EU's regulation of financial benchmarks does not conflict with the IOSCO and G20 principles and mandates, and rather provides leadership in efforts to enhance the coordination and consistency of cross-border regulation.
Such increased coordination and consistency has been emphasized in recent speeches by Michel Barnier, European Commissioner for the Internal Market and Services. We very much hope it will remain a major focus of the upcoming Commissioner for Financial Stability, Financial Services and the Capital Markets Union.

Yours Sincerely,