EU ASIA
Financial Services Round Table

BRIEFING PAPER

BENCHMARK REGULATION - IMPACT IN ASIA-PACIFIC

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Overview of market concerns

It is difficult to determine the notional value of the financial exposure that Asian benchmarks and indices have to European markets. Much of that information is proprietary and competitive so financial institutions are unable to share that data so that it could be aggregated. While we may not be able to determine the exact value, we do know that many of the major benchmarks, particularly foreign exchange and interest rate benchmarks, are widely used in Europe, especially for international swaps, derivatives and other structured products (we typically see 25-40% usage from the EU for major country interest rate benchmarks).

In an effort to gauge the impact of the BMR in Asia, ASIFMA conducted a survey in August 2016 that included administrators across the region. They were able to provide a high-level picture of industry exposure and estimated that the BMR would affect as many as 55 Asia-based benchmarks. While 18% of survey participants felt that the BMR would not impact their business model, another 36% believed that they would not be able to determine their exposure as they do not track nor have data on the users of benchmarks. The survey thus showed that a significant proportion of the major benchmark administrators in Asia-Pacific expect their business models to be impacted and that many benchmark administrators find it difficult to determine to what extent they may be impacted. In other words, given the lack of clarity in terms of the scope of the BMR, both administrators and users, have found it challenging to identify what benchmarks are required to be compliant with the regulation.

Lack of clarity around equivalence

Decisions regarding the continuity of use of benchmarks referenced in certain types of contracts will need to be taken well in advance of the January 2020 phase-in. Without equivalence decisions in the coming months, or further clarity around whether equivalence is likely, EU based users may have to find alternative benchmarks to reference, if at all available, possibly as early as Q4 2018 and certainly in Q1 and Q2 2019. While regulators and administrators in some jurisdictions in Asia have taken steps that will allow them to begin conversations with European regulators regarding possible equivalence of their regulatory framework and/or supervisory environment under the BMR, the time available before important decisions have to be made by the users of benchmarks in those jurisdictions is limited. In addition to this, and specifically with regards to the FX market, which is a vital tool for European businesses doing business on a cross-border basis, there is also the issue of the lack of incentives for administrators to seek equivalence, something that had not been envisaged by the regulation. Further, there is considerable lack of clarity around whether these jurisdictions or relevant administrators will achieve equivalence in time for the January 2020 phase-in date. There has been no clarity on whether equivalence discussions have begun in those jurisdictions and whether equivalence will be granted before users need to begin to make decisions in early 2019 on whether they maintain their use of non-compliant benchmarks in Asia.

Limited options for recognition or endorsement

For benchmark administrators that wish to pursue recognition or endorsement, either because they are in jurisdictions not seeking equivalence or because they are not in a position to pursue equivalence themselves, the possibility of achieving either of this is limited. There are a number of reasons for this:

- Most administrators based in Europe that have benchmarks in Asia have only recently obtained authorisation approval.
- There is potentially considerable cost required to obtain and maintain recognition for a third country administrator. Only the largest benchmark administrators will be able to bear that cost.
- There is a lack of clarity as to which European National Competent Authority (NCA) to apply to for recognition. Many Asian benchmark administrators do not know where their benchmarks have the highest exposure, and not all European NCAs are keen to, or even have a process for applying.
- The risks and role authorised benchmark administrators should play when endorsing third country benchmark administrators remains uncertain. The nature and extent of a "well-defined role" as required under BMR Article 33 for an endorsing supervised entity in the third country benchmark is uncertain, and some Asian benchmark administrators will be reluctant to grant the EU Administrator unclear access and control.
- Such uncertainty also means the potential financial burden is unclear. While costs and the nature of involvement is uncertain, only certain benchmarks would be financially viable as prospects for endorsement and only certain providers with specific expertise would feel confident enough to endorse benchmarks in Asia.
- Whilst recognising that certain Asian benchmarks are IOSCO-compliant, for which the compliance should be taken into account for the equivalence assessment, a number of benchmarks in APAC are yet to be fully IOSCO compliant and there is a significant amount of change and investment required by the administrators before an endorsement or recognition application can be made.
- Brexit is causing further uncertainty as to where to apply, but also around the ability of authorised/recognised EU administrators to offer endorsement or legal representative services since the majority applied to the UK FCA and how the process would operate as the EU member state of reference might alter after Brexit.

Of the five officially authorised benchmark administrators under the BMR, only two firms have publicly stated they will offer endorsement to administrators outside the EU and no benchmark administrators have officially announced they will pursue endorsement with a specific provider. No benchmarks outside of the EU have been registered as compliant by ESMA.

The lack of options and uncertainty will also increase the burden on administrators that do offer endorsement as they will be forced to manage the transition to that framework with multiple benchmarks with the limited time available before the phase-in. The EC or ESMA should develop proportionate principles for the monitoring of third country administrators by EU administrators. This might take the form of guidance like that recently issued for CRAs by ESMA.

Recommendations - Taking into account the issues outlined above we believe the European Commission and ESMA should:

1) The majority of our members find it essential for legal certainty to consider extending the transitional provisions applying to third country benchmarks to allow more time for the European Commission, National Competent Authorities and ESMA to complete their ongoing work on equivalence, recognition, and endorsement. This would also prevent potential market disruption should those decisions not be ready before January 2020.While sharing the same concern, a minority of members suggested a more targeted extension of the transitional provisions to cover for example critical benchmarks, benchmarks having the most disruptive effect on investment and/or where the equivalence, recognition or endorsement processes have commenced but not been concluded
2) Consider granting further time to EU authorised administrators that have begun work taking on the administration or endorsement of third country benchmarks to meet the phase in date.
3) Consider designating 1 January 2020 as the date where the Registration Application or the Equivalency Application may be received, rather than registration under an equivalence decision granted.
4) Provide further clarity regarding the legal liability of an EU legal representative of a non-EU administrator seeking recognition could advance discussions in this area.
5) Provide further information regarding the specific process and requirements for endorsement and the expectations that have for firms that seek it. This should include principles for monitoring and the access required by the EU administrator for the third country administrator.
6) Outline the specific criteria, information required and timelines for equivalence that will be considered when reviewing legislation in third country jurisdictions. Work with other regulators to agree as to the appropriate level of supervision for third country benchmarks and to communicate this to the market.
7) Allow certain NCA's to be designated by ESMA (in addition to NCA of the country where trading takes place).

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The EU-Asia Financial Services Roundtable promotes a shared understanding of the regulatory issues faced by financial markets participants in Europe and Asia, while also shaping the EU-Asian regulatory and policy discussions. Its members are Afore Consulting, AIG, DTCC, HSBC, IHS Markit, London Stock Exchange, Moneygram, Moody's, Nex, Nomura, Standard Chartered and Thomson Reuters.

It supports regulators in developing an appropriate and balanced regulatory framework that enables long-term growth in both Europe and Asia, whilst identifying areas where regulation impedes the international flow of capital or creates unnecessary barriers to doing business. It supports the development of regulatory best practice, and a level playing field in financial services regulation in Europe and Asia, whilst promoting open and stable financial markets.