MORRISON
FOERSTER

Unofficial transcript for users of mofo.com

Melissa (00:00:00):

Good afternoon. My name is Melissa, and I will be your conference operator today. At this time, I would like to welcome everyone to the new benchmark for financial transactions conference call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks, there will be a question and answer session. If you would like to ask a question during this time, simply press star and the number one on your telephone key pad. If you would like to withdraw your question, press the pound key. Mr. Green, you may now begin your conference.

Peter Green (00:00:29):

Thank you very much. So I'm Peter Green, a partner in the capsule markets group at Morrison & Foerster based in London, and I'm presenting with my colleague, Jeremy Jennings-Mares, also a partner in the capital markets group here in London. And we're also very lucky to be joined today by Mark Schaedel, managing director of IHS markets index services, which provides custom index calculation and administration services to providers and users of financial benchmarks. And he's joined by his colleague David Cook, head of European regulatory affairs. At IHS markets, David was previously first factory at the UK European regulatory—sorry, at the first to the UK representation to the EU leading the negotiations of financial services legislation in Brussels for the UK government. Both Mark and David will give us their views of the challenges facing market participants and the overall readiness of the market from their perspective in relation to the Benchmark regulation.

Peter Green (00:01:45):

We are now, of course, very close to the implementation date for the regulation, which is the first of January next year. So just over six months away. Uh although as we'll see, there are important transitional provisions in relation to the regulation, it will, from the start of next year, have a profound impact on the use of financial benchmarks within the EU. And as of global interest to issuers, arrangers, and investors in the financial securities and markets. You will hopefully all receive copies of the slide presentation for today's sessions, and I'll try and keep you noted as to where we are in the presentation as we go through it. So moving to slide two which just says that—a little bit of history there that has of course been a particular focus on the setting and administration of financial benchmarks following investigations into manipulation of setting of LIBOR, UI board, and other financial benchmarks as a result of those investigations.

Peter Green (00:02:58):

We had the weekly review in the UK, which led to various reforms in relation to LIBOR setting and administration. And LIBOR's now under supervision and regulation by the UK FCA, and subsequently other specific benchmarks have been bought into the FCA's regulatory oversight, including the so overnight index average. Sonya the WM [inaudible], is closing rates and others as set out on the slide. So, moving to slide three, at an international level in July, 2013, IOSCO published its final report on principles for financial benchmarks, setting out various principles and recommendations in relation to benchmark regulation, and those principles remain in effect today. Shortly thereafter and closely based on the IOSCO principles, the

EU commission published a draft regulation seeking to establish a pan-European approach to the regulation of benchmark administrators, contributions, and users. And as we'll see, the regulation takes a different approach to previous regulation of benchmarks and the current UK approach, which tended to focus on a small number of critical benchmarks. In contrast, the EU regulation draws the net very widely in terms of benchmarks that fall under it, regulatory umbrella, and then limits the extent of that regulation for non-significant benchmarks.

Peter Green (00:04:51):

Even so, the regulation is going to impose a much greater set of regulatory obligations and oversights for all benchmarks that come within its scope, even non-significant ones. After a long legislative process, the regulation came into force on the 30th of June, 2016. As mentioned, most of the provisions of the regulation will become live from the start of next year. Although certain provisions in relation to critical benchmarks applied immediately upon the regulation coming into fourth and certain provisions amending the market abuse of regulation applied from July last year to dovetail with that regulation becoming effective.

Peter Green (00:05:39):

So onto slide four, which sets out the definition of benchmarks to which the regulation would apply—it is very wide. So, in relation to financial instruments and financial contracts, it applies to any index by reference to which the amount payable under such instrumental contract is determined or by which the value of the instruments determined. And, in relation to investment funds to any index used to measure the performance of such funds either with the purpose of tracking the return of the index or defining the asset allocation of the portfolio or in the competition of performance fees. Uh, then given off benchmarks, the, the definition of index on slide five is similarly wise and this applies to any figure that's published or made available to the public and regularly determined in whole or in part by a formula assessment on the basis of the value of one or more underlying assets or prices or action estimated interest rates.

Peter Green (00:06:56):

So here that the—a lot of folks has been on what is meant by an index being available to the public. This issue has been addressed by ESMA, the European securities and market authority, in technical advice to the European commission. The final version of which was published in November last year. [Inaudible] view is that an index is available to the public. If it's accessible by a large or potentially indeterminate number of legal or natural persons like size of the provider's legal entity, and that potentially indeterminate limb really does widen what's available to the public means. And an index will be regarded as made available to the public irrespective of whether it's provided free of charge, whether or not accessed directly or indirectly, and regardless of the medium used to make the index available. So even if the index data is made available to investors in a specific single instrument, although that may seem to be a narrow set of investors, very arguably, that is an indeterminate number of investors because the security is being freely transferable.

Peter Green (00:08:22):

The group of [inaudible] holders is uncertain. Also, where an investor can derive index values from published differentials values of financial instrument site prices or coupon, that's also likely to put the index within scope of the regulation. So many proprietary indices are likely to have the potential to come within the [inaudible] of the regulation. Briefly on slide six, we just cover what comprises financial instruments for the purpose of the regulation. Again, this is drawn widely by reference to annex one-C of method two, which will include many transferable securities, many marketing instruments and derivatives. To come within the amateur regulation, the instrument must be traded on a trading venue within method two or through a systematic intern advisor. So essentially, an investment firm acting as a market maker. A financial contract is broadly any consumer credit agreement or residential mortgage, and investment fund is either an alternative investment fund under the, AFMD or usage fund under the uses for directive, and

that all comprises a very wide range of instruments.

Peter Green (00:09:47):

I set out on slide seven—there are certain entities that will fall outside the scope of the benchmark regulation. So central banks, public authority is contributing data or have a consortium, but the provision of a benchmark for public policy reasons and central case parties in that capacity of providing reference or settlement prices for this management purposes and settlement purposes. Also, the provision of a single reference price for any financial instrument is stated to—for outside the scope of the regulation. And there's also an exemption in relation to commodity benchmarks based on submissions from contributors where the majority of the contributors are a non-supervised entity, provided at the benchmarks referenced by financial instruments traders trading venue, and the close promotional value of financial instruments referencing the benchmark doesn't succeed a hundred million euros. There's also an exemption where the provider of an index is unaware, and couldn't reasonably have been aware that the index is used as a benchmark.

Peter Green (00:11:07):

So moving to slide eight and the provisions relating to administrators of benchmarks—so benchmark of administrators will be subject to a new authorization and supervisory regime under the regulation. And for these purposes, an administrator is to find as any natural or legal person that has control over the provision of a benchmark. There's no specific guidance as to what control means in the regulation, but the definition is likely to be construed pretty widely. So any personal entity that's involved in producing a financial benchmark should consider whether it comes within the scope of the regulation as a benchmark and administrator, and any benchmark administrator located in the EU must apply to as relevant competent authority for authorization if it provides or intends to provide in for use, as benchmarks will come onto what use means a little later. Uh, the activities of benchmark administrators that are relevant for the purposes of the regulation are the administration of the arrangements for benchmark determination, collecting, analyzing, and processing input data, and the actual determination of the benchmark. I set out on slide nine—if the benchmark administrator is already supervised under own relevant EU financial regulation such as [inaudible]or the AFMD, that entity doesn't need to go through a full authorization process under the regulation, but still needs to be registered as a benchmark administrator with the relevance competence authority. As I alluded to earlier, there are transitional provisions, which are very important in relation to the implementation of the regulation.

Peter Green (00:13:07):

So any administrator, whether inside or outside of the EU, that was providing a benchmark as of 30, June, 2016, when the regulation came into force, will have 42 months, or until the first of January, 2020, to apply for authorization or registration. But these transitional rules only applied to indices that were actually provided by such an administrator back when the regulation came into force last year. There are, however, further transitional rules that may catch indices that were first divided after this time that I'll come onto in just a moment. Moving to slide 10, we've set out here a broad summary of the requirements that benchmark administrators are subject to, and to the regulation aimed at maintaining the integrity and reliability and relevant benchmarks. And these include requirements to have in place, robust governance arrangements, including a clear organization or structure with well defined, transparent, and consistent rules and responsibilities for all persons involved in the provision of the benchmark.

Peter Green (00:14:25):

And as administrators will also be required to take adequate steps to identify and prevent or manage conflicts of interest, and to ensure that where any judgment or discretion is required in the benchmark determination process is exercised independently and honestly. Benchmark administrators will also be required to establish and maintain effective oversight function to ensure oversight of all aspects of the provision of their benchmarks. And there are specific requirements in relation to the establishment of

controlled and accountability, frameworks, and record keeping, and outsourcing. And various requirements also apply to input data, including that it should be sufficient to accurately and reliably represent the marketing for economic reality that the benchmarks intended to measure. And the data should, where possible, be transaction data if available and appropriate in the circumstances. As Jeremy will mention shortly, where a benchmark is based on input data from other contributors—

Peter Green (00:15:38):

—the benchmark administrator is required to develop a code of conduct specifying the contributors responsibilities in relation to the contribution of input data. I set out from slide 11—the regulation also provides transitional relief where an existing benchmark doesn't meet the requirements of the regulation if and to the extent that [inaudible] will changing the benchmark to comply with the regulation would result in a force majeure event or frustrate or otherwise reach the terms of any existing financial contracts or instruments or the rules of any investment funds, which reference the benchmark. And as we've said out on slide 11, ASMOS published technical advice in its final report of November, 2016, setting out factors on which confidential authority should determine whether these transitional provisions apply to a benchmark. Importantly, for the purpose of this transitional relief, ESMA considered that an existing benchmark is one that exists on, on the first of January, 2018.

Peter Green (00:16:52):

So it's possible the benchmark created after the regulation came into force in June, 2016 could benefit from this relief. But no new benchmark created from January, 2018 will be able to benefit from any of the transitional relief under the regulation. So it would only be able to be used in the EU if the relevant administrator is authorized or registered in accordance with the regulation. So, I think that sets the scene you—in terms of the, you know—scope and the basic obligations in relations, benchmark administrators. So, Mark and David, I'd like to ask you for your initial views on the impact of the regulation, having regard to its wide scope and whether having drawn it that widely means that we'd like to see many industries being withdrawn into course, and that perhaps being a chilling effect on new industries being used in the market as benchmarks.

David Cook (00:17:57):

Thanks Peter. Yes, good question. I think there—one of the issues around the benchmark regulation is that although it's very clear that the legislator's intent is to cast the net very wide, there still remains even this close to the application of the regulation, a great deal of uncertainty over how wide the scope will exactly be. And although, you know, you set out very well where we are at the moment, we haven't quite had the final rules and the final intent from national regulators in their implementation of where that net will go to. So, for example, you have to have an indice, an index that's public. Well, you know, ESMA has given it technical advice, but it's only technical advice and there's been a difficult discussion within the European commission about how they will actually give their final position.

David Cook (00:19:05):

And I know there's been a lot of representations about trying to create a system where sort of tailored bilateral arrangements are not captured, but anything more is going to be captured. And I think the—there are potential loopholes that the commission has been trying to close, but that matter, I don't think, has been fully resolved, or how that will be implemented hasn't been fully resolved. There's also questions around how the blending of different kinds of index will work. And although the legislation says that the combining in, indices itself is not benchmark administration that is because there's no discretion being used and it, and it remains to be seen how, you know, what exactly the interpretation of discretion will be. Furthermore, the issue around the transitionals is also confusing a number of people with an active—there are many different ways of reading what is a relatively vague piece of regulation.

David Cook (00:20:16):

And I know that again, ESMA has asked the commission to try and clarify exactly how it should be interpreted for everybody. And the interpretation that you've given is the one that ESMA and the FCA have said is how they expect it to be interpreted. But there has been some political pressure building around a so-called more favorable treatment for benchmarks coming in from outside the EU. But I think what is clear is that everybody is expected to comply with these rules from the first of January, and regulators, like the FCA, have indicated that they don't want to have discussions about whether people are in or out of scope of the benchmark regulation. If they feel if there is a conflict of interest in the, in what you are offering clients, you should deal with it. So I think where there will be a lot of confusion will be people who are getting caught in scope without realizing it.

David Cook (00:21:24):

And it remains to be seen how that kind of confusion might impact the market and then how, as people roll forward, their process of getting authorized or registered, how the transitional arrangements might impact that approach as well. So, you know—you may see some, you know—I don't expect to see a huge change with a lot of withdrawal from the market, but I expect to see a lot of change in the way business is done. IOSCO principles are well established, and I think that's most, or some of the effort needed to be compatible with the benchmark regulation, but you may see some tightening around licensing rules and a rush to make sure that that people are compliant, especially if they're caught out by thinking they're not in scope of the regulation.

Peter Green (00:22:22):

Thank you very much. That's that that's all very interesting and I mean, I guess there's some company there or there, I think we're, we're pretty used to, with a lot of financial regulation, it's obviously still a lot of uncertainty. You with we're now obviously very close to implementation—six months is not that long in terms of people getting ready. So you know obviously some of the issues that you've highlighted were further input may come—could be very useful, but you know, it's obviously time is fairly short, being this is also for your observations on sort of the—I think you slightly touched on this, but yeah. Observations generally on the preparedness of the market, generally for compliance with the requirements of the regulation, particularly the requirements the benchmark administrative has given, we are now just a few months away from the implementation date and also possible solutions that may be available to providers of benchmarks in meeting their obligations under the regulation.

Mark Schaedel (00:23:46):

Yeah. So this is Mark. Thank you again for inviting us to speak. I think we've seen a fair amount of—I'll call it reluctance or delay in terms of initial implementation steps and preparation due to the scoping issue. And I think that was somewhat the circular discussion that almost—at some point where I think there was a lot of questions around some of the terms used and the scope and the effect and reach overall. That was made clearer through the process, but as David mentioned, I think is not yet necessarily giving anyone a satisfactory form of comfort. And I would say the other is really a lack of complete understanding on the options of how to mitigate risk. I think that's very prominent for users of benchmarks who might find themselves becoming an administrator tomorrow, but no less prominent for providers of benchmarks who are finding some of the nuances in terms of the definition of benchmarks and scope to be quite challenging as well, as well as how to necessarily affect it—

Mark Schaedel (00:24:59):

And I guess the challenge that we've set out has been asked by clients to step into is really how to mitigate the conflict of interest risk, which is clear to everyone, and was really the purpose of the overall spirit of BMR. And I think setting out on that course makes sense as a priority. And I think where we think there are more options than then a lot of our clients may understand or may have understood early days. So those

focused on the separation of IP ownership and the responsibilities to become an administrator and deal with the regulatory compliance, and the fact that those two could be separate persons or separate entities performing those duties or maintaining IP ownership without having to be responsible for the regulatory compliance aspects as long as control, as you mentioned, is transferred to that administrator.

Mark Schaedel (00:26:02):

So we've taken a very close look at that—provided a number of client's recommendations, and we've onboarded a number of clients where we're now an independent administrator on their behalf. And we've established that control chain by effectively taking ownership of the artifacts, which contain the methodologies and putting them into a control framework and process so that changes to them are governed by our oversight process. And that's effectively a solution at a high level. I think most of our clients, both providers and users of benchmarks find that the discretion, the areas of discretion that, that David touched on are rather broad and, and some case nuanced and ambiguous. So, we've looked for solutions which completely transfer areas of expert judgment as you might call it, or use of discretion to take a conservative approach. I think the result which we're seeking to avoid is there's any question about whether there's more than one administrator of a benchmark, where there might be two parties involved in decision making or exercising that judgment.

Mark Schaedel (00:27:12):

So that that's where we've really focused and tried to perfect our model, but I think we've seen a good deal of, I guess of, most of the obstacles being, how you, in fact, transfer that control. How, in fact, you establish ownership outside of, say for example, an issue of structured products, the trading desk themselves has the most expertise in those products. How do you transfer responsibility internally to a ring fence function without that expertise, and those models, I think reached a level of challenge where it makes sense to look at how an independent party could play that role. And, and that's what we've established ourselves as a means to ease the path forward.

Peter Green (00:28:02):

Terrific. Well, that that's extremely helpful, and I know we'll sort of get further and put some from you on some other issues a bit later, but I just wanted to cover a few other sort of more specific areas under the regulations. So, moving to—slide 13, it's just worth noting that the regulation does provide some specific rules for different types of benchmarks. So for commodity benchmarks with some inventions such as goals and silver due to specific concerns for commodity benchmarks, administrators are subject to additional requirements including making public methodology used for the benchmark calculation. And the administrator here must also specify criteria that define the commodity that's subject to particular methodology and is also required to give priority to concluded transactions in the input data.

Peter Green (00:29:15):

Commodity benchmarks are also not eligible for some of the release relating to significant and non-significant benchmarks that that we'll come on to shortly on to slide 14. There were also specific requirements for interest rates, benchmarks where concerns have been raised in particular as to input data used for these benchmarks, and the needs were possible for this to be based on real transactions. So, accordingly, a specific priority of use of input data is specified for interest rates, benchmarks, primarily. These benchmarks should be based on contributors transactions in the underlying market that the benchmark's measuring, or if not, sufficient data in related markets. And if there's not sufficient input data from these sources, then the benchmark can be based on observations of third party transactions in relevant markets or paying in that committees or indicative quotes.

Peter Green (00:30:24):

The administrative and interest rate benchmark must also have in place an independent oversight

committee and is subject to additional records-keeping requirements. And then I said that briefly on slide 15 for benchmarks that are determined by the application of input data contributed entirely and directly from certain regulated venues. These benchmarks, so exempt from certain of the governance and control requirements that would otherwise apply, then turn into critical benchmarks. And slide 16— so the EU commission is required to adopt implementing legislation to establish and review at least every two years. A list of critical benchmarks is provided by administrators in the EU. There are various tests, which I, I won't go through in detail as to whether a benchmark is a critical benchmark, but that there is quite a high threshold.

Peter Green (00:31:35):

So the first test being that it's used directly or indirectly for financial instruments or contracts measuring— or measuring the performance investment funds with the total value at least 500 billion euros. So it is aimed at the biggest and most significant benchmarks born and to date by the fact that ESMA actually only designated one critical benchmark so far [inaudible], although it has indicated that designations of further benchmarks as critical benchmarks may follow. As we've set out the bottom of slide 17 and the top of slide 18, critical benchmarks are subject to additional requirements. The administrator must take adequate steps to ensure the licenses of, and information relating to, the benchmark are provided to all users on a fair, reasonable, transparent, and non-discriminatory basis, and at least every two years must submit to its relevant, confidential authority and assessment of the capability of the benchmark to measure the underlying market or economic reality.

Peter Green (00:32:51):

The relevant competence authority also has to establish a supervisory college for each critical benchmark. That comprises the competence authority of the administrator and all supervised contributors to the benchmark, as well as ESMA itself. Then we've set out—which I'm going to go through in any detail on slides 19 or 20—the special rules that apply where administrator or contributors to a benchmark in the case of administrator wants to cease providing a benchmark or, in case of a supervised contributor, to stop making contributions. And there's basically then a consultation process with the relevant competence authority, and the college of supervisors that can effectively require the benchmark to continue to be provided by the administrator or contributions to be continued to be made by the supervisor contributor for a period of 12 months, possibly extending to 24 months in some circumstances. Then, moving to slide 21—

Peter Green (00:34:06):

—as I alluded to, if a benchmark is sort of a critical benchmark, it's going to be categorized either as significant or non-significant under the regulation. The tests for significant benchmarks set out on slide 21 relate to the volume of instruments, which reference the benchmark or the effects on the market at the benchmark no longer being provided, and any benchmark that's not a critical or significant benchmark is a non-significant benchmark for the purposes of the regulation. And on slide 22, the administrator of a significant benchmark may choose on a comply-explain basis not to apply certain provisions of the benchmark regulation that would otherwise apply, including things that need to operationally separate the provision of a benchmark from parts of its business for conflict of interest reasons and certain of the provisions relating to intelligence of employees and personnel and contributors if it considers that complying with these provisions would be disproportionate—

Peter Green (00:35:22):

—having regard to the nature of impact of the benchmark. And I think, you know, really picking up on something David was saying before, I think there's still a lot of uncertainty as to how that's going to be applied in practice by personal competence authorities and how strictly they're going to require providers of normal critical benchmarks to comply with the follow on after the benchmark regulations or the extent of which they would allow relief under these provisions. Administrators of non-significant benchmarks,

again on a comply-explain basis, can choose not to apply [inaudible] list of provisions from the benchmark regulation, including many of the specific requirements relating to the oversights and control functions. So with that, I'm going to hand over to Jeremy, who's going to amend other things, consider rules relating to contributors and the impact of the regulation to non-administered benchmarks. Just before doing that, I'm going to read CID code for those that need it, which is 1706-40. That's 1706-40. Jeremy.

Jeremy Jennings-Mare (00:36:45):

Thanks, Peter. So, just looking at slides 23 and 24, without going into too much detail, this is just worth noting on these slides that the regulation also provides some specific provisions for contributors. So when you have a contributor that's a natural legal person contributing input data, then the administrator of the benchmark has to develop a code of conduct, which sets out the contributor's responsibilities in relation to the contribution of that input data. And you'll see the kind of things that the code of conduct has to—it's like if you have to—has to contain, as well as the provisions on slide 24, the other requirements in relation to contributions that apply to supervised entities specifically. But if you then turn to slide number 25, so this is one of the real nubs of the regulation.

Jeremy Jennings-Mare (00:37:58):

Essentially, the rule that a supervised entity is only going to be permitted to use a benchmark in the EU if it's provided by an administrator who's authorized or registered under the regulation. So the question occurs, what do we mean by using a benchmark? So, it provides for very specific circumstances. Firstly issuing a financial instrument, which references an index or a combination of indices. Secondly, determining the amount payable under a financial instrument or a financial contract by referencing the index. Thirdly, being a party to a financial contract, which references the index. Fourthly, the possibility of a creditor providing a borrowing rate that's expressed as a spread or a markup over an index, where that rate is solely used as a reference in financial contract to which that creditor is the party. And then the fifth head for this is using a benchmark also includes measuring the performance of an investment fund through an index for the purpose of tracking the return or defining the asset allocation of a portfolio or alternatively for computing performance fees.

Jeremy Jennings-Mare (00:39:18):

If you could turn to slide 26, the endless technical advice they've issued in this regard does actually sort of go further into the meaning of what issuing a financial instrument means. And it essentially means the creation of a transferable security or a money market instrument or a unit in a collective investment scheme to be sold to potential investors by way of a public offer or placement or alternatively by way of the instrument being administered to trading on either a regulated market [**inaudible**] trading facility or an organized trading facility. So, what this means, as you can see from the different definitions of use, are one thing that is not prevented is that supervised entities are not prevented from acquiring or holding or trading a financial instrument that references an index, even where the administrator isn't compliant with the benchmark regulation.

Jeremy Jennings-Mare (00:40:19):

You—when we're talking about an OTC derivative—now this bullet point in 26 actually should say that parties to an OTC derivative are not actually considered to be issuing a financial instrument; however, they are still likely to be deemed using the benchmark by virtue of either the second or my third heads of using a benchmark that I talked about earlier. It also required the supervised entity have to provoke-produce robust written plans that set out what actions would be taken if the benchmark should materially change or cease to be provided any longer. If you could turn to slide 27, we'll start talking about non-EU benchmarks. So firstly, the—what we call the transitional provision, which you know, as been discussed earlier, is not the clearest piece of drafting. Generally, it's understood to mean that where you have a non-EU administered benchmark that was already used in the EU on the date that regulation came into force, then the effect of the transitional provision is to grandfather the use of that benchmark for existing

financial instruments, contracts, investment funds until first of January, 2020.

Jeremy Jennings-Mare (00:41:49):

Apart from the transition of provisions, if you have a non-EU benchmark, then you—if you're not—either, if it's after the transitional period or if the grandfather isn't available because of the terms of the transition, essentially there are three alternative routes for an EU benchmark to the used in the EU. One is equivalence. The second is recognition, and third is endorsement. So what do those mean? Slide 28, equivalence. It's possible for ESMA to register a non-EU benchmark administrator and the non-EU benchmark if the EU commission adopts an equivalence decision for the jurisdiction in which the administrator is located. Now this will—in addition to this equivalence decision, the administrator has to be authorized or registered in their jurisdiction. They have to—the administrator has to notify a consent to the benchmarks being used by supervised entities in the EU.

Jeremy Jennings-Mare (00:42:56):

And in addition, it's required that there are cooperation arrangements in place between ESMA and the relevant authority in the third-party jurisdiction, at least covering the mechanism for exchanging information and coordinating supervisory activities. Now in slide 29, what do we mean—in what circumstances are—is the commission going to make an equivalent decision? Essentially, it has to be happy either on a general basis that administrators that are authorized or registered in the non-EU jurisdiction do comply with binding requirements that are equivalent to those under the regulation. Alternatively, it can make a more specific determination that it satisfied that binding requirement in that relevant jurisdiction with respect to specific administrators or specific benchmarks are in fact equivalent to the requirements under the benchmark regulation. Now, in both of these cases, there's a reference which crops up in many places for non-EU benchmarks referencing the—whether or not the framework and the supervisory practice complies with IOSCO principles.

Jeremy Jennings-Mare (00:44:11):

It's not immediately clear exactly what the intention is in terms of the how the IOSCO principles feed into the question of equivalence, for instance; however, it generally seems to be that IOSCO compliance will be viewed as a kind of base entry requirement for any successful determination of equivalence. So in other words, that essentially, you would need to be compliant with the IOSCO principles, and if not, it is—it's unlikely that there would be any positive equivalence decision for that particular jurisdiction. So in each case, also, the commission has to be satisfied. Administrators are subject to effective supervision and enforcement on an ongoing basis. At the present, it's probably worth noting that there's probably limited scope for many equivalence to be taken for a while. Although Brexit may well change that situation as to which I'll talk a little bit later. On slide 30, the second method for using non-EU benchmarks is a method of recognition.

Jeremy Jennings-Mare (00:45:29):

So until such funds, [**inaudible**] determination is made in relation to the relevant non-EU jurisdiction, a benchmark administered in that jurisdiction can be used by supervised identities in the EU, so long as the non-EU administrator has obtained prior recognition from what's called its member state of reference in the EU. Now, determining the member state of reference is not exactly straightforward, and there are various possible criteria. And in order of priority, it's firstly determined by the location of any affiliated supervised entities in the EU. When, you know, if there are more than one of them where most of those are based, if that's not determinative. Secondly, the location of any relevant trading venues for financial instruments that reference the relevant benchmark. And again, if that's not determinative, then you look at the location of the supervised entity actually using the benchmarks. Now under this method, relevant non-EU administrators are going to need to comply with the vast majority of the obligations that apply to EU administrators under the regulation.

Jeremy Jennings-Mare (00:46:42):

Although there is a provision that says that that can be considered to be fulfilled by compliance with the IOSCO principles so long as the relevant competent authority determined that those principles are in fact equivalent to compliance with the benchmark regulation. A little bit circuitous, you might think, and not immediately clear at the moment how that is actually going—the IOSCO principles are actually going to feed these decisions. Turn to slide 31. Another requirement for recognition is that the non-EU administrator has to appoint a legal representative in the member state of reference to perform an oversight function in respect to the relevant benchmark. And that legal representative is going to be accountable to the competent authority of that member state of reference in relation to the benchmark. So we can see there are a few challenges for the recognition process. Firstly, the problem of identifying who your member state of reference is. Secondly, how to determine how easy it's going to be to demonstrate compliance with the IOSCO principles, and thirdly, the headache of having to appoint a legal representative in that jurisdiction.

Jeremy Jennings-Mare (00:47:56):

So turn to slide 32. And the third method for EU benchmarks is called endorsements. So another EU administrator can also position benchmarks for use in the EU. If an application is made to the relevant competent authority to endorse the use of the relevant benchmark in the EU—now that application can be made either by a benchmark administrator supervising the EU or alternatively by another supervised entity located in the EU who has a clear and well-defined role within the control framework of another EU administrator. In either case, that relevant entity must be able to monitor effectively the provision of a relevant benchmark. Before relevant competent authority will make an endorsement, it has to be satisfied of a number of things. Firstly, that the applicant is able to demonstrate that the provision of the benchmark fulfills requirements at least as stringent as the benchmark regulation. Turn to slide 33—that they have the necessary expertise to monitor the provision of benchmark and manage the associated risks.

Jeremy Jennings-Mare (00:49:16):

And thirdly, that there is an objective reason to provide the benchmark in the non-EU jurisdiction and for it to be endorsed for use in the EU. And ESMA has set out various measures that will be relevant, various factors that will be relevant as to whether there is such an objective reason, such as the geographical proximity to the relevant market, the specific skills, whether you need to rely on skills and expertise and parties in third countries, and equally whether there are any legal restraints from obtaining input data directly from that third country. So, again, the reference crops up to the IOSCO principles that in determining whether or not the provision of the benchmark is subject to at least as stringent requirements as the benchmark regulation, the competent authority can take into account whether or not it complies with the IOSCO principles.

Jeremy Jennings-Mare (00:50:16):

It's also worth noting that in this circumstance, the endorsing administrator does remain responsible for the endorsed index and for ongoing compliance with the regulation. So at this stage I thought I'd just take a break and ask you based upon the—those different methods applicable to non-EU benchmarks, whether Mark and David perhaps had any observations in particular on whether they considered likely that non-EU administrators will seek to use one of these methods to, you know, to register in the EU—you know, any sort of particular issues they foresee, whether we think perhaps that any benchmarks may—we may see withdrawn perhaps after the transition period. And so, Mark and David, if you got any thoughts on that.

David Cook (00:51:13):

Yeah, thanks. I think it's worth saying again, the challenge here is the lack of real clarity and certainty in what has been agreed by the legislators around third countries. The idea of an equivalence regime is well established in EU law. But here, it was realized there was a tension and the reason you can't—it's hard to

understand what the legislator wanted is there was a tension of two different parties in the agreement of this regulation that those who thought an equivalence regime would work and those who recognized that no one else, no other jurisdiction, was moving towards a concrete law around the implementation of the IOSCO principles. So the reason we also have two routes of endorsement and recognition that are largely untested and therefore uncertain how they're going to work is because they—there was an understanding that they were creating a problem about the use of third-country benchmarks through the system they did. Now, that has changed because there will now be a jurisdiction outside the EU that has a legal system, and that will be the UK.

David Cook (00:52:36):

But one thing to remember with any equivalence decision is it is highly political, and therefore—and the commission can withdraw it as well, which makes it very difficult for businesses to plan to use it in the long term. And then the other, the other processes, as I said, it's hard to understand how they will actually be enacted because they'll be enacted by individual entities working with individual regulators and all—and I think what we can see potentially emerging is very different approaches, very different regimes, being run by one national authority compared to something being run by another national authority, which may well have a profound implication for the way third-country benchmark administrators act. And then overall, there is a very big risk that some third-country benchmarks will have to stop being used. But I think the authorities are waking up to this and they have committed to try and ensure that, as long as there's cooperation, that routes can be found.

David Cook (00:53:52):

And then one final thing that I'd just like to highlight is an issue that's affecting a number of people who operate a number of firms that operate on a global basis is it's actually not very easy to pinpoint the location of the administration of a particular benchmark, especially those that draw either expertise or contribution or users from a number of jurisdictions. And actually, that is—that's yet another area where you may get different approaches from national authorities. So if you—if you have a benchmark there, you draw contributions from Asia, you have your operations in India, you have some expertise in New York, and perhaps an oversight committee in London. What will the regulator see as the location? Is it a third-country benchmark, or is it a European benchmark? That's going to be a fundamental question. And again, I think, you know, some regulators may say, "Right, if you have a license near you, it covers your global business." Others may say, "If you have a license in near you, it only for parts of your business that are definitely in the EU." And again, that causes more uncertainty in terms of how the administration will take place.

Jeremy Jennings-Mare (00:55:19):

That's great. Thank you very much for that. So there's a couple more things that we could certainly cover on this, but I wonder actually whether now might be a good time just to check whether there were any particular questions that anyone else may have that we can address. And if not, we can just sort of wrap up with a few last comments.

Melissa (00:55:45):

At this time, I would like to remind everyone in order to ask a question, please press star, then the number one on your telephone keypads. Again, if you would like to ask the question, press star, then the number one on your telephone keypad.

Peter Green (00:56:17):

Whilst we are waiting for any questions, I'll also just one last time, read the CLE codes for those who need it. And the code is 1706-40, that's 1706-40.

Melissa (00:56:47):

There are no questions at this time. Do you have any closing remarks?

Jeremy Jennings-Mare (00:56:52):

Yes. Okay. So, just to sort of finish off the—just to sort of mention on slides 34, we've set out some of the powers of supervision and enforcement that competent authorities have under the regulation. Slide 35 also mentions there are some other sort of little related amendments that are made to certain other pieces of European legislation, which you can see set up on that slide. On slide 36, it's probably just worth mentioning, there's a small matter coming up of the UK leaving the EU. How does that relate to the benchmark regulation? So, eventually, benchmark regulation is going to become effective before Brexit, before the UK leaves the EU. Once it does leave the EU, the regulation is going to cease to apply in the UK as a regulation.

Jeremy Jennings-Mare (00:57:59):

However, it will be replicated into UK law under what's called the Great Repeal Bill. And that will happen at the time of Brexit. So effectively on Brexit day, there will be a piece of legislation in place which is equivalent to the regulation. However, thereafter, the UK government will be free to make subsequent amendments or repeal any of the provisions of that UK legislation. Having said that, it seems to us reasonably unlikely that making amendments to, you know, the bench, the regulation of benchmarks under this legislation is going to be high on the list of anyone's priorities following Brexit. But essentially assuming the benchmark regulation ceases to apply in the UK, then we will be left with a position whereby any benchmark administrator located in the UK is going to need to rely on either equivalence or recognition or endorsement.

Jeremy Jennings-Mare (00:59:09):

At least after the transition or provisions have expired, in order to ensure that the relevant benchmark can continue to be used in the EU. And this is fairly likely to be one of the many things that are going to have to be covered as part of the Brexit negotiations. It's also just as a point to note talking about equivalence because of the effect of the Great Repeal Bill, it will be case that the day after Brexit, the UK will be essentially the most compliant—the most equivalent non-EU jurisdiction in terms of the benchmark regulation. And therefore, one would think that there should be no barriers at all to determining, you know, and the EU commission determining an equivalence decision in favor of the UK. However, it's worth noting that like many things related to Brexit, this is going to be a very political issue. And nothing can be taken for granted at the moment in that regard. So—

Peter Green (01:00:22):

And it's Peter here. I mean, I entirely agree with that. I mean, as David alluded to earlier, equivalence is, you know, it is discretionary, it can be withdrawn, so it's not an answer to everything. But it would certainly be, you know, if we can't get to this admission arrangement whereby the benchmark mitigation is regarded as equivalent, then I think things are going to go pretty badly in relation to discussions between the EU and the UK. It would be quite surprising to me, and if there isn't any say transitional arrangements whereby the UK's regards as an equivalent in this regard. As Jeremy said, of course, politics is everything. And we will wait and see on that.

Jeremy Jennings-Mare (01:01:12):

So, yeah, maybe just to sort of—couple of final thoughts. I don't know. Peter, Mark, David, whether you want to add anything just to sort of wrap up the session?

Mark Schaedel (01:01:27):

So I guess I would just encourage those in a position to assess their own exposure to benchmark regulation

would be to look separately at the risks related to the legal regulatory and reputational, each by themselves. I think each offers, I would say, an opportunity to look very closely at exposure, but also at helping identify options for mitigation and ways of achieving best practice as a means of going forward, both in terms of compliance with this regulation, but also as an opportunity potentially to enhance efficiency and find different ways of achieving the same outcome differently. And obviously, we're keen to explore those, share any lessons learned with you that we've come across in our dealings, and helping clients and our own preparations for becoming an authorized administrator, which has been has been full of interesting ups and downs. So we welcome that as a follow up to anyone that's interested.

Peter Green (01:02:54):

Yeah. And it's Peter, I mean, also from my perspective we'll be very happy to—anyone that does have any follow-up questions or observations, do feel free to contact us. Yeah, I think as will be—as has been clear from this presentation, yeah, we have a pretty clear set of framework requirements, but there is, you know, as David and Mark alluded to, there's still a lot of uncertainty as to how this is really going to be ruled out in practice and how provisions are going to, you know, be applied by the relevant authorities in due course. We do have the benefit of transitional provisions, which are, you know, going to certainly give many parts a bit more time to get things sorted out [**inaudible**] to existing benchmarks. So, you know, while six months isn't that far away, many existing benchmarks will still be able to rely on the transitional provisions for a while.

Peter Green (01:04:00):

But you know, again, you know, those, as they alluded to the application of those is also not entirely straightforward. So they'll also raise lots of questions and things to be resolved. And we're very happy to answer any further questions that people listening to this presentation may have. So with that, I would like to thank everybody for listening and participating in the presentation. I would very much like to thank, again, Mark and David for the very helpful insights into the regulation and its effects. And so, from Jeremy and myself, thank you to everyone for listening and participating.

Mark Schaedel (01:04:52):

And thank you, Peter. And thank you, Jeremy, for having us.

Jeremy Jennings-Mare (01:04:55):

Thank you.

Melissa (01:04:57):

This concludes today's conference call. You may now disconnect.