S&P Dow Jones Indices Position Paper on the European Commission's Targeted Consultation on the Regime Applicable to the Use of Benchmarks Administered in a Third Country

Introduction

S&P Dow Jones Indices (S&P DJI) is a global independent index provider, headquartered in the United States with operations around the globe. As an index provider which has actively contributed to the policy discussion regarding the IOSCO Principles and the EU Benchmarks Regulation (BMR), we welcome the opportunity to comment on the Commission's consultation.

We believe that the Commission's consultation represents a strategic milestone in the life of the BMR which provides an opportunity to resolve a number of longstanding challenges associated with the scope of the regulation, the third country regime, and the need to apply the principle of proportionality.

Under the EU BMR, S&P DJI operates an authorised benchmark administrator in the EU located in the Netherlands (S&P DJI Netherlands B.V.), which is supervised by the Dutch Authority for Financial Markets. S&P DJI Netherlands B.V. also acts as the endorsing administrator for certain benchmarks administered outside of the EU. S&P DJI also operates a benchmark administrator in the UK (IHS Markit Benchmark Administration Ltd.), which is supervised by the UK Financial Conduct Authority under the UK BMR.

Third Country Regime: State of Play

S&P DJI was one of the first benchmark administrators to have its third country benchmarks endorsed under Article 33 of the EU BMR. However, identifying an appropriate third country mechanism to use was not straightforward and involved an extensive evaluation while engaging with the Commission, ESMA, and the appropriate National Competent Authorities (NCAs) to determine which mechanism would function best for S&P DJI.

Equivalence

As an administrator headquartered in the United States, Article 30 of the BMR did not provide a route to access the Single Market given that no equivalence decision for the United States was likely from the European Commission.

Recognition

The recognition mechanism under Article 32 of the BMR at first appeared to present a potential solution because approval applies at the entity level. However, at the time of our assessment Article 32 involved a convoluted and highly complex process to identify a 'Member State of reference'. In addition, the roles and responsibilities of the legal representative and the administrator required under the recognition regime continue to be uncertain and raise questions of extra-territoriality. We note the requirements regarding the identification of a 'Member state of reference' were subsequently removed under Regulation (EU) 2019/2175.

Endorsement

The only viable option for S&P DJI was therefore endorsement under Article 33 of the BMR. Meeting the requirements for endorsement was not a simple task and continues to pose challenges.

First, endorsement requires the incorporation of a new entity with sufficient substance to act as an EU authorised benchmark administrator. S&P DJI therefore established a legal entity in the Netherlands and relocated employees to provide local index management and operations in the Netherlands. It also required obtaining authorisation for that new Dutch entity to be an EU benchmark administrator which could act as the endorsing entity for third country benchmarks.

After a full benchmark administrator license was obtained under the general authorization mechanism in the BMR, a second application process was required to permit S&P DJI's EU administrator to act as the endorsing administrator on a benchmark-by-benchmark basis, even though those indices are administered using the same governance and oversight framework across all of S&P DJI.

However, even after the endorsement mechanism is approved further obstacles exist. One such example is the ESMA register. The process for endorsing entities to register each third country index is extremely laborious. We encountered problems almost immediately once we began uploading third country benchmarks in 2019. We were more than a little surprised by the limitations of the register and the complexity involved in the manual process.

Of course, given the mechanisms of the third country regime, EU benchmark administrators who do not endorse or recognise third country benchmarks do not have to undertake this laborious and time-consuming process involving the register for each and every benchmark used in the EU. This means that global benchmark providers and third country benchmark administrators are at a particular disadvantage because of the difficulties they face getting their products onto the ESMA register.

Third country benchmark administrators therefore face an additional burden when compared to EU administrators because of the challenges highlighted above. There are a large number of third country indices used as benchmarks in the EU and the current regime is cumbersome and has the potential to limit innovation and the growth of index-based investment solutions in the EU.

Finally, a significant barrier to the successful adoption of either recognition or endorsement is the level of access and control a third country benchmark administrator must grant to a legal representative (Article 32) or an endorsing administrator (Article 33) to permit those agents to fulfil their respective obligations under the BMR. Equally, a legal representative and an endorsing administrator assume a high level of risk and liability by undertaking those roles under the BMR. As a consequence, the market for service providers offering to act as the legal representative and/or endorsing administrator for an unrelated third party is unlikely to develop.

Additional Extension of the Third Country Regime

The end of the third country transitional period poses significant uncertainty for third country benchmark providers and for users of benchmarks. S&P DJI therefore supports the additional extension of the third country regime by the European Commission to at least 31 December 2025, as provided for under Article 54 of the BMR. Unless the issues cited above related to the third country regime and scope are resolved further extensions in future may also be necessary.

“Strategic Benchmarks” Concept

We would cautiously welcome the introduction of the concept of “strategic benchmark” as outlined in the consultation document as a possible solution to the overly broad scope of the BMR. This concept presents an interesting and viable policy option to resolving both the question of scope and third country access, which are inextricably linked.

For instance, such a concept could take a risk-based approach regarding the nature of the benchmarks in question (for example, descoping indices that are less prone to potential manipulation like Regulated Data Benchmarks) or only focus on certain designated labels that already exist under the BMR. This policy direction would also be supported by the fact that there is a general prohibition against manipulating the calculation of a benchmark under Article 22 of the Market Abuse Regulation, with associated potential sanctions.

However, it is unclear what the “strategic benchmark” concept would mean in practice as very little detail is provided in the consultation. We would welcome further clarity and consultations with benchmark providers prior to the implementation of such a policy choice given the potential risks of an unclear definition being introduced which may exacerbate existing problems with the BMR or create an unlevel playing field among providers and which could distort the market for benchmarks.

Our understanding of the proposal is that – once the BMR is amended accordingly – only certain benchmarks (both third country and EU), designated “strategic”, would fall within scope of the BMR. This would mean that the use by EU supervised entities of all EU and third country benchmarks not designated as “strategic benchmarks”, would in principle be free without any regulatory requirements under the BMR for either the benchmark provider, the users of non-strategic benchmarks, or the contributors.

However, it is challenging to assess and understand the “strategic” benchmark concept without more detail. In this regard, we would urge the Commission to adopt a clear and transparent framework that would be used to establish “strategic benchmarks” in order to provide certainty as well as clarity to benchmark providers and market participants. Such a framework should be sufficiently narrow to address the scoping issues highlighted in the Commission’s consultation paper and to help achieve the original proportionality objectives of the BMR.

For example, “strategic benchmarks” would need to have a number of clear criteria to allow the Commission to designate them as well as to allow benchmark providers, NCAs, and market participants to identify which benchmarks do not fall into the potential scope for designation. These criteria could include:

- Systemically important for the EU market, where the benchmark has systemic relevance for the Union and the cessation or disruption of such a benchmark would likely lead to Union stakeholders being exposed to risks of legal uncertainty and disruption to the functioning of financial markets;

- Not including Regulated Data Benchmarks or benchmarks using regulated pricing as an input;

- Criteria to identify benchmarks that are more vulnerable to potential manipulation;

- Benchmarks used directly as a reference for financial instruments or financial contracts or for measuring the performance of investment funds, that have a total value of at least €500 billion; and

- Benchmarks with no, or very few, market-led substitutes.

We also believe a more appropriate term for these benchmarks is "Designated Benchmarks" as opposed to "strategic". The word "strategic" has the connotation of tactical or planned importance and is liable to be misconstrued by market participants. It may also give the impression of an endorsement thereby distorting competition within the market.

Unless the number of "strategic" benchmarks were limited to a manageable number it is highly likely that the same issues identified above regarding scope and the third country regime would re-appear following the introduction of a "strategic benchmark" only scope.

We do not believe factors such as total value or specific benchmark designations, such as EU Climate Transitions or EU Paris-aligned Benchmarks, should automatically mean a benchmark is deemed "strategic" or "Designated". Benchmark administrators should be provided a reasonable mechanism to dispute whether the designation of a benchmark as "strategic" is warranted. The Commission and any other relevant authority involved in the designation process should also be required to consult with the relevant administrator and with the relevant NCA prior to designating a benchmark as "strategic".

Finally, consideration also needs to be given to current BMR authorizations, registrations, recognitions, and endorsements for existing administrators. We would like to understand what impact the introduction of a "strategic" benchmark concept would have on existing approvals to act as an authorized, registered, recognizing, or endorsing benchmark administrator. It is unclear, for example, whether administrators who do not administer "strategic" benchmarks would be required to give-up their authorised or registered status.

ESG Benchmark Label

We support the leadership the EU has taken in the field of sustainable finance, particularly in terms of greater reporting and transparency. However, as a general comment, the Commission risks adopting conflicting positions by introducing an ESG label for benchmarks while also reconsidering the scope of the BMR itself.

On the one hand, as explained above, there are significant impediments to the full implementation of the BMR, which are acknowledged in the consultation including the prospect of rescoping the legislation. On the other hand, the Commission would appear to be increasing requirements for specific benchmark designations.

We would therefore urge the Commission, and the co-legislators, to refrain from introducing mandatory minimum requirements for ESG benchmarks and to limit any prospective regulatory requirements for an ESG benchmark to a voluntary label.

Regarding the potential introduction of a specific ESG benchmark label, the Level 1 text of the BMR was clear in the mandate provided to the Commission in this respect. Article 54(5) states that (our **emphasis**):

> "the Commission shall present a report to the European Parliament and to the Council on the impact of this Regulation and the feasibility of **an 'ESG benchmark'**, taking into account the evolving nature of sustainability indicators and the methods used to measure them".

The mandate does not request the introduction of minimum requirements for all ESG benchmarks, nor does it suggest anything more than the introduction of an opt in label for a benchmark similar to the Climate Transition Benchmarks (CTB) and Paris Aligned Benchmarks (PAB), which were introduced at the same time as Article 54(5). This was because the amendments to the BMR at the time introduced sweeping and granular ESG disclosure requirements for all benchmarks subject to the BMR.

It would be completely disproportionate and out of line with the better regulation principles to ignore the amendments already introduced which require ESG disclosure on all benchmarks when considering this mandate to conduct a feasibility study on "an ESG benchmark".

The potential introduction of mandatory minimum requirements for all ESG benchmarks would also risk contravention of the Article 4 of the BMR (including Delegated Acts under Article 4(9)), which is intended to ensure that a benchmark administrator should have appropriate governance arrangements in place to protect the integrity of the benchmark and that it should maintain responsibility for all aspects of the provision of a benchmark, including development and methodology. This principle was potentially already put in question when the BMR required benchmark administrators to "endeavour to provide" CTB and PABs in Article 19b of the BMR. The requirement raises questions about whether the BMR respects the independence of benchmark administrators and whether it goes too far by interfering with methodological decisions.

If an ESG benchmark label is enacted then a benchmark administrator should not be required to "endeavour to provide" it, as is the case for EU CTBs under Regulation (EU) 2019/2089. We have consistently held the position that the requirement that benchmark administrators "endeavour to provide" one or more EU CTBs under Article 19(d) of the BMR is problematic. It sets an undesirable precedent in EU financial services regulation by forcing a benchmark administrator to undertake an activity it may not wish to undertake, and it presents several other risks:

- This provision is not consistent with the objectives of the EU Benchmark Regulation "to ensure the accuracy and integrity of indices used as benchmarks". Moreover, it is unclear what the provision requires of a benchmark administrator in practice and what the consequences are of not "endeavoring to provide" one or more CTBs;

- The provision could also be read as requiring a benchmark administrator to continue to produce a benchmark following potential changes to the relevant Delegated Acts, which the administrator is not able or competent to undertake;

- Requiring a benchmark administrator to provide a benchmark regardless of whether it believes the underlying methodology is sound or is capable of managing the benchmark, represents an unprecedented interference in the independence of benchmark methodologies;

- Requiring benchmark administrators that may not have necessary expertise on climate benchmarks to try to provide benchmarks which may not be fit-for-purpose potentially introduces market risk. This could expose benchmark administrators and, in turn, regulatory authorities, to litigation risk.

We would suggest that no future requirement be introduced to the BMR to require benchmark administrators to produce a certain product. These risks undermine the integrity of and distort the market for indices. Moreover, we believe these risks would be addressed by removing the requirements of Article 19(d) altogether.

In addition, regarding the question of an ESG label, apart from the potential interference in benchmark determination process relatively rapid obsolescence is a serious risk with codifying methodological standards for benchmarks into legislation. For example, a significant downside to codifying methodological standards is that the standards can become outdated relatively quickly, particularly in an evolving space such as ESG. Investor conviction, improved disclosure, disclosure standards and research techniques are rapidly changing drivers of innovation. Hardwiring criteria into legislation and then requiring benchmark administrators to "endeavour to provide" certain labelled benchmarks risks distorting the market for indices by curtailing innovation and hampering best practice based on new developments.

Furthermore, if the Commission does proceed with a voluntary ESG benchmark label, we would urge it to ensure the standards are clear and achievable. We have identified a number of issues with the minimum standards enacted for EU CTB and PAB, particularly regarding the scope of the exclusions under Article 12(1) of Delegated Regulation (EU) 2020/1818 and the "do not significant harm requirements". The matter of "do not significant harm" is problematic because the legislative framework under the Sustainable Finance Disclosure Regulation (SFDR) is incomplete and is inconsistent with the "do no significant harm" requirements under the Taxonomy Regulation.

Finally, while we understand and appreciate the challenges in making the SFDR practicable, the solution to resolving problems with definitions that exist in the SFDR is not to reverse engineer the BMR to invent benchmarks that will meet the Commission's preferred interpretation of Article 8 and Article 9 definitions. Any problems that exist in the SFDR should be resolved in the SFDR.