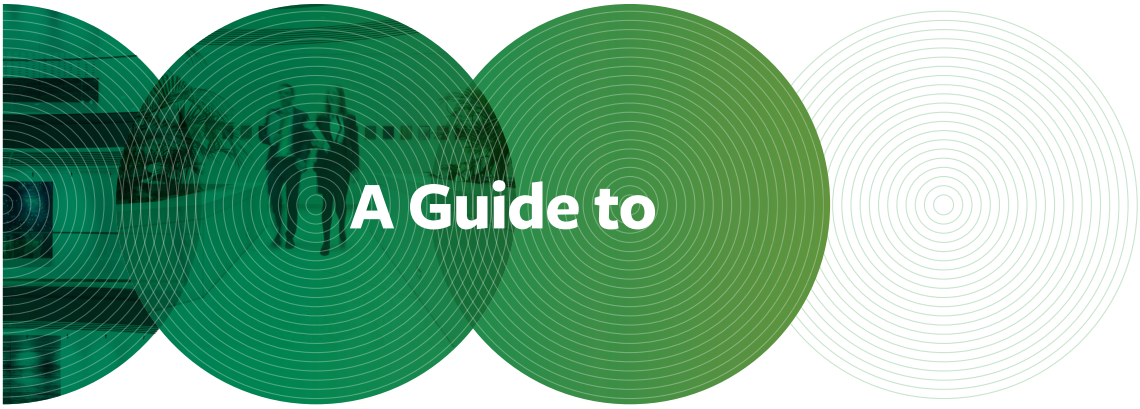

McCann FitzGerald

Q&A on the Proposed Benchmark Regulation

The EU's Benchmark Regulation ("**BMR**") imposes requirements on certain firms that provide, contribute to or use a wide range of financial benchmarks. In-scope firms, including: banks; investment firms; UCITS, Alternative Investment Funds ("**AIFs**") and their managers; as well as certain non-bank lenders, must ensure that they comply with those requirements by 1 January 2018.

What is the Benchmark Regulation?

The BMR is part of the EU's response to the LIBOR/EURIBOR manipulation scandal. It lays down a regulatory framework for benchmarks, which is designed to reduce the risk of benchmark manipulation and promote confidence in their integrity and that of the financial markets which they support.

The European Commission has published four draft delegated regulations supplementing the BMR.

ESMA has also published a Q&A on the BMR.

What is a "benchmark"?

The BMR defines a "benchmark" as an index that is used for specific purposes. It defines an "index" to mean any figure that is published or made available to the public and that is regularly determined:

(i) entirely or partially by the application of a formula or any other method of calculation, or by an assessment; and

(ii) on the basis of the value of one or more underlying assets, prices, interest rates, quotes or other values or surveys.

The relevant index must be used for the purpose of:

- determining the amount payable under, or the value of, a financial instrument as defined under the MiFID II Directive 2014/65 that is traded on a trading venue or via a systematic internaliser;
- determining the value of a "financial contract", namely a credit agreement under the Consumer Credit Directive 2008/48 or the Mortgage Credit Directive 2014/17; or
- measuring the performance of an investment fund (AIF or UCITS) with the purpose of tracking the return of the index, or of defining the asset allocation of the portfolio or of computing the performance fee.

Does the BMR cover all benchmarks?

There are a number of important exceptions from the scope of the BMR. Specifically, it does not cover benchmarks which reference a price of a single financial instrument or those provided by central banks or other authorities for public policy purposes. Standard variable rates offered by credit institutions are not considered benchmarks when used in mortgage or consumer credit contracts.

Does the BMR apply in the same way to all types of benchmarks?

The BMR distinguishes between different types and different categories of benchmarks in order to provide a proportionate response to their related risks. There are four broad types of benchmarks; interest rate, commodity, regulated data and other (non-commodity) benchmarks. There are three categories of benchmarks, namely, critical, significant and non-significant. The BMR imposes the most stringent requirements on critical benchmarks.

Who is in scope of the BMR?

The BMR imposes requirements on benchmark administrators, supervised contributors, and supervised entities.

What is a benchmark administrator?

An "administrator" is any person, natural or legal, that has control over the provision of a benchmark. A person provides a benchmark by:

- administering the arrangements for the purpose of determining a benchmark;
- collecting, analysing or processing input data for determining a benchmark; or
- determining a benchmark through the application of a formula or other method of calculation or by an assessment of input data provided for that purpose.

What is a supervised contributor?

A supervised contributor is a supervised entity that contributes input data to an administrator located in the EU.

What is a supervised entity?

Broadly, the term "supervised entity" is defined to cover regulated financial service providers, including: banks, investment firms, (re)insurers, UCITS and UCITS Managers, and AIFs and Alternative Investment Fund Managers ("**AIFMs**"). However, the term also covers creditors, within the meaning of the Consumer Credit Directive as well as non-credit institutions under the Mortgage Credit Directive. An administrator is also a supervised entity.

What obligations does the BMR impose on administrators?

The BMR sets out a new regulatory and supervisory regime for benchmark administrators. In this respect, it introduces authorisation/registration requirements for persons located in the EU that intend to act as an administrator.

In addition, each benchmark administrator must comply with a wide-ranging set of requirements, set out in Title II of the BMR, regulating: governance and conflicts of interest; internal oversight; control frameworks; accountability frameworks; record-keeping; complaints handling; outsourcing; input data; benchmark methodologies; reporting of infringements; and the development of a code of conduct.

The precise nature and extent of those requirements depends on the type and category of the relevant benchmark being administered. Generally:

- regulated-data benchmarks are not subject to a number of the Title II requirements;
- interest rate benchmarks are subject to specific requirements laid down in Annex I of the BMR, which apply in addition to, or as a substitute for, the Title II requirements;
- commodity benchmarks are mainly subject to the requirements set out in Annex II of the BMR instead of those set out in Title II; and
- administrators of significant and non-significant benchmarks may choose to disapply some of the Title II

requirements subject to the fulfilment of certain requirements, including the publication of a compliance statement that explains why this is appropriate.

An authorised/recognised benchmark administrator must also publish a benchmark statement as well as a procedure concerning the actions to be taken in the event of changes to or the cessation of a benchmark which may be used in the EU.

The administrator of a critical benchmark must notify its competent authority if it intends to stop providing the benchmark and may be required to continue publishing the benchmark for a specified period.

What obligations does the BMR impose on supervised contributors?

A supervised contributor must put in place governance and control measures designed to ensure the integrity and reliability of the input data which it contributes, including measures to protect against conflicts of interest, controls around who may submit input data, training for submitters and record keeping arrangements. This obligation does not apply to contributors to a regulated-data benchmark and may be partially disapplied by the administrator of a non-significant benchmark.

If a supervised contributor to a critical benchmark intends to stop supplying input data, it must notify the benchmark administrator, which must in turn inform its competent authority. In certain circumstances a supervised entity can be required to contribute input data to a critical benchmark.

What obligations does the BMR impose on supervised entities regarding the use of a benchmark?

Generally, a supervised entity may only use a benchmark in the EU, if the benchmark is provided by an authorised or registered administrator in the EU or, in the case of third countries, where an equivalence decision is in place, the third country administrator has been recognised or the benchmark has been endorsed. ESMA will maintain a register of such administrators and benchmarks ("**Register**").

As the BMR does not apply to central banks, ESMA considers that supervised entities in the EU are allowed to use benchmarks provided by third country central banks, even though these will not be included in the Register.

Must a supervised entity immediately stop using benchmarks provided by a non-authorised or registered EU index provider from 1 January 2018?

No, in certain instances a supervised entity will be able to continue using such benchmarks. Specifically, a supervised user can continue to use a benchmark provided by an EU index provider that was already providing a benchmark on 30 June 2016, including new benchmarks provided by the EU index provider

for the first time after 1 January 2018, until 1 January 2020 or unless and until authorisation or registration is refused.

In circumstances where an EU index provider first starts to provide benchmarks between 30 June 2016 and 1 January 2018, a supervised entity can use any benchmark provided during this period until the above-mentioned dates. However, a supervised user cannot use new benchmarks provided by such an index provider after 1 January 2018.

What other obligations does the BMR impose on supervised entities?

Each supervised entity that uses a benchmark must produce and maintain a robust written plan setting out the actions that it will take in the event that a benchmark materially changes or ceases to be provided. The supervised entity must reflect these plans in its contractual relationships with clients.

Where the object of a prospectus published under the Prospectus Directive 2003/71 or the UCITS Directive 2009/65 is transferable securities or other investment products that reference a benchmark, the issuer, offeror, or person asking for admission to trading on a regulated market must ensure that the prospectus includes clear and prominent information stating whether or not the benchmark is provided by an administrator that is on the Register.

When does an entity "use" of a benchmark?

An entity "uses" a benchmark when it:

- issues a financial instrument which references a benchmark;
- determines the amount payable under a financial instrument/contract by referencing an index or a combination of indices;
- is party to a financial contact which references an index or combination of indices;
- provides a borrowing rate calculated as a spread or mark-up over an index or combination of indices and that is solely used as a reference in a financial contract to which a creditor is a party;
- measures the performance of an investment fund through an index or a combination of indices for the purpose of tracking the return of such index or combination of indices, of defining the asset allocation of a portfolio, or of computing the performance fees.

How should I prepare for the BMR?

The first task will be to determine if your organisation is within scope of the BMR, and if so, in what capacity, whether as an administrator or otherwise.

Each administrator should assess whether it will need to become authorised, registered, or have its benchmark endorsed under the BMR, and take any necessary steps in this regard. An inscope administrator will also need to put in place the measures necessary to comply with any applicable Title II and related requirements and publish one or more benchmark statements.

Each supervised contributor must put in place policies and procedures that ensure that it meets the BMR's requirements aimed at ensuring the integrity of its submissions.

Each supervised entity must ensure that it identifies each benchmark it uses and seeks assurance from the administrators of those benchmarks that they will comply with the BMR. This is particularly important in the case of the non-EU administrators of smaller benchmarks. A supervised entity must also:

- identify potential alternative benchmarks in case any benchmark it currently uses becomes unavailable;
- put in place robust, written contingency plans, in case a benchmark materially changes or ceases to be provided; and
- reflect these plans in the contractual relationships with clients.

Issuers, offerors or persons asking for admission to trading to a regulated market of a prospectus to be published under the Prospectus Directive 2003/71 or the UCITS Directive 2009/65, which has as its object transferable securities or other investment products, must also ensure that the relevant prospectus includes the information required under the BMR. In the case of prospectuses approved prior to 1 January 2018 under the UCITS Directive, the underlying documents must be updated at the first occasion or at the latest within 12 months after that date.

Are there any sanctions for infringing the BMR?

The BMR requires member states to provide appropriate administrative sanctions and other administrative measures in relation to certain infringements. In the case of a legal person, this includes pecuniary sanctions of up to EUR 1 million or 10% of the person's annual turnover, or that of the group of which the person is part.

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