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NOTE

From:	Presidency
To:	Delegations
Subject:	Proposal for a Regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts *- Progress Report*

I. INTRODUCTION

1. On 18 September 2013 the Commission transmitted to the Council its proposal for a Regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds.

2. The proposal has been examined by the Working Party on Financial Services in eight meetings during the Italian Presidency (10 and 24 July, 17-18 September, 6 and 31October, 17 and 25 November, 12 December). Only the first two meetings in July were held with the experts, whereas, as from September they were held at attachés only level.

3. During the discussions in the Working Party on Financial Services the Presidency has tabled four compromise proposals (docs. 12983/14, 14753/14, 15936/14 and 16539/14) in order to make progress on the file, given that the proposal was issued 9 months before and that most of the Member States' major concerns with it were already discussed under the former Hellenic Presidency.

4. The European Central Bank and the European Economic and Social Committee delivered their opinions on 7 January 2014 and 21 January 2014 respectively.

II. STATE OF PLAY

5. Generally speaking, the initiative of the European Commission has been well received as, in light of the major scandals occurred with some widely used financial benchmarks, there is a general consensus that a stronger and more uniform regime in this area is needed, with the only main concern relating to the possibility to continue to make use of the benchmarks provided by entities located in third countries, as reportedly no other jurisdictions outside Europe will have adopted equivalent legislative action by the time the Regulation is due to enter into application.

6. After the last meeting of the Working Party on 12 December 2014, the IT Presidency considers that a number of issues having debated so far are recognised as settled by the vast majority of Member States. For instance, it has been made clear that the combination of indices does not amount to administration of a composite benchmark but rather to the use of its components. Another example pertains to the transparency requirements which have been calibrated, i.e. by removing the obligation for administrators to publish input data and by specifying that the publication of the methodology is to be meant as the disclosure of its key elements rather than the underlying formula.

In addition, in order to calibrate the provisions in the Regulation to suit different types and sectors of benchmarks (i.e. for the sake of 'proportionality'), while preserving at the same time the broad scope of application, the IT Presidency worked to better differentiate the requirements applicable to the relevant administrators. In the fourth compromise text there are a specific regime for regulated-data benchmarks – essentially characterised by several exemptions from the material requirements applicable to all other financial benchmarks, to take into account the quality of input data and the limited discretion of the administrator – a regime for interest-rate benchmarks - whose provisions now better mirror the IOSCO Principles for financial benchmarks pertaining the input data sufficiency and the input data hierarchy - a regime for critical benchmarks – for which major amendments have been introduced to address some issues that caused much concerns at the onset of negotiations (i.e. the removal of an automatic quantitative trigger for the exercise of the mandatory contribution power) – a regime for commodity benchmarks - which have been kept as close as possible to the inherent sectorial IOSCO Principles.

A registration regime was introduced as an alternative to the authorisation regime for administrators of financial benchmarks, under specific conditions. It has been acknowledged by Member States hitherto that the registration regime is not meant as a differentiation either of the applicable material requirements or of the supervision to be carried out by the competent authorities with respect to the activity of administrators.

In order not to prevent the use of benchmarks provided from administrators located in third countries until such time as a fully-fledged equivalence (in terms of legal framework and supervisory practice) would not be possible, the IT Presidency introduced in the text a suit of complementing and transitional measures: a grandfathering provision, aimed at consenting supervised entities in the Union to continue to use existing third country benchmarks for the financial instruments and contracts that will be outstanding at the time of entry into application of the Regulation so as to avoid a "cliff effect"; a recognition process, according to which benchmarks provided by a third country administrator might be used in the Union on condition of the existence of a cooperation arrangement between a EU competent authority and a corresponding third country competent authority for the administrator; an endorsement process, which instead relies more on the private initiative and thus on the possible agreement between an EU administrator and a third country administrator; a review clause according to which, depending on the outcome of an assessment of the degree of development at

international level, the Commission could eventually adopt a legislative proposal to possibly amend the Regulation concerning the equivalence of third countries.

Finally, the IT Presidency has worked to find out the most appropriate link between the first level provisions and the second level measures so as to balance the sometimes contrasting requests from Member States. This implied the insertion of some of the provisions formerly contained in Annexes into the main body of the Regulation as well as the insertion of the empowerment for ESMA to draft regulatory technical standards on a number of technical issues.

7. After the meeting of 12 December 2014 it appeared that further debate is necessary before seeking guidance at political level as to the options to be followed regarding the following issues:

a) Critical benchmarks –definition and implications

The Commission suggested in its original proposal the identification of critical benchmarks based on the majority of contributors to the benchmark being supervised entities and the existence of financial instruments, referencing that benchmark, with a total notional value of at least 500 billion euro. The main implications of the designation of a benchmark as critical consisted in the possibility for the national competent authority to have a say on the contents of the Code of Conduct (which is a possibility now envisaged for all benchmarks) and to exert the power to require the mandatory contribution to the benchmark by the supervised contributors to it under specific circumstances, the constitution of a college of supervisors.

Most Member States argued against the one-size-fits-all approach and instead proposed the use of qualitative elements in the definition. The Presidency therefore acknowledged that a benchmark has to be considered as critical whenever its cessation or provision on the basis of input data or a panel of contributors no longer representative of the market or economic reality the benchmark itself seeks to measure would have an adverse impact on markets integrity, or financial stability, or consumers, or the real economy, or the financing of households and corporations in one or more Member States. Such a definition proved helpful also in order to accommodate the request by some Member States to have the

possibility to designate national critical benchmarks, notwithstanding the perplexity of some other Member States, for which the national competent authority could exert the mandatory contribution power, if needed.

Nonetheless, a few delegations consider that there could be other benchmarks relevantly diffused within the Union, so as to deserve at least the constitution of a college of supervisors so as to allow the competent authority of a Member State, in which a benchmark is significantly used, to have a say on the major decisions under the surveillance regime for the administrator of such benchmark. So far, it proved hard to conciliate such request with the views of many other delegations which rather prefer to maintain the category of the critical benchmarks as narrow as possible and to base its definition on certain quantitative criteria.

b) Colleges of supervisors - ESMA binding mediation

Under the proposal by the Commission a college should be constituted for each administrator providing at least a critical benchmark, whose composition, apart from the national competent authority of the administrator and ESMA, should encompass the competent authorities of the supervised contributors and the competent authorities in the Member States where the benchmark is more widely used. The decisions to be taken at the level of the college includes the authorisation of an administrator and its withdrawal, the measures of mandatory contribution and the sanctions. In case of failure in finding an agreement on these decisions, ESMA would intervene with a binding mediation.

Member States are just simply divided in two groups: one group wanting to maintain the binding mediation of ESMA for almost all of the decisions referred to above and those wanting to delete any reference to the ESMA binding mediation power of intervention.

The IT Presidency explored two different alternatives so far, respectively consisting in the limitation of the binding mediation to the case of the withdrawal of the authorisation of an administrator and the adoption of the mandatory contribution measures and in the limitation of it just to the mandatory contribution measures.

III. CONCLUSION

8. Against this background the Presidency proposes that the Working Party on Financial Services:

- takes note of the progress achieved with regard to the proposal;
- takes note of the latest Presidency compromise proposal, as set out in doc.16539/14, and
- invites the incoming Latvian Presidency to continue to work on the basis of this compromise proposal in order to reach an agreement on a general approach at the beginning of 2015.