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COVER NOTE

From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
date of receipt:	13 July 2018
To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
No. Cion doc.:	C(2018) 4430 final
Subject:	COMMISSION DELEGATED REGULATION (EU) .../... of 13.7.2018 supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council with regard to regulatory technical standards for the procedures and characteristics of the oversight function

Delegations will find attached document C(2018) 4430 final.

Encl.: C(2018) 4430 final



Brussels, 13.7.2018
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COMMISSION DELEGATED REGULATION (EU) .../...

of 13.7.2018

supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council with regard to regulatory technical standards for the procedures and characteristics of the oversight function

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds (the Benchmark Regulation) introduces a common framework to ensure the accuracy and integrity of benchmarks referenced in financial instruments, financial contracts or investment funds in the European Union. In doing so it aims to contribute to the functioning of the internal market, while achieving a high level of consumer and investor protection.

This Delegated Regulation is based on a mandatory empowerment in Article 5 of the Benchmark Regulation. The issue of subsidiarity was covered in the impact assessment for the Benchmark Regulation.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

In accordance with Article 10 of Regulation (EU) No 1095/2010 ESMA has carried out a public consultation on the draft regulatory technical standards. A discussion paper was published on 15 February 2016 on the ESMA website and the consultation closed on 31 March 2016. An open hearing on the discussion paper was held on 29 February 2016 in Paris. On 29 September 2016, a consultation paper which included a first version of the draft technical standards was published. The consultation ended on 2 December 2016.

In addition, ESMA sought the views of the Securities and Markets Stakeholder Group (SMSG) established in accordance with Article 37 of Regulation (EU) No 1095/2010. The SMSG submitted its response on 11 November 2016.

Together with the draft technical standards, and in accordance with the third subparagraph of Article 10(1) of Regulation (EU) No 1095/2010, ESMA has submitted an analysis of costs and benefits related to the draft technical standards. This analysis is available at http://www.europe-economics.com/publications/ee_bmr_final_report_9-02-2017.pdf.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

The right to adopt regulatory technical standards is provided for under Article 5(5) of Regulation (EU) 2016/1011. Under these provisions, the Commission is empowered to specify the procedures regarding the oversight function and the characteristics of the oversight function.

Article 1 specifies further the composition of the oversight function.

Article 2 specifies further the characteristics and positioning of the oversight function.

Article 3 specifies further the procedures governing the oversight function.

COMMISSION DELEGATED REGULATION (EU) .../...

of 13.7.2018

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(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014¹, and in particular Article 5(5) thereof,

Whereas:

- (1) Article 5 of Regulation (EU) 2016/1011 requires administrators of benchmarks to establish a permanent and effective oversight function which should be carried out by a separate committee or by means of another appropriate governance arrangement.
- (2) Administrators have the discretion to design the most appropriate oversight function for the benchmarks they provide to fulfil the requirements of Article 5 of Regulation (EU) 2016/1011. This Regulation sets out a non-exhaustive list of appropriate governance arrangements.
- (3) Entrusting external stakeholders with an oversight function can provide valuable expertise and their participation can increase the effectiveness of the oversight function. Conflicts of interest within that oversight function may arise due to the conflicting interests of those members or due to relationships between members of the oversight function and their clients or other stakeholders. To mitigate such conflicts, independent members that are free from conflicts of interest should, where possible, be included in those overseeing critical benchmarks due to their importance for market integrity, financial stability, consumers, the real economy and the financing of households and businesses in Member States. Where such independent members are not required in accordance with this Regulation, administrators should adopt other procedures to address potential conflicts of interest such as excluding members from certain discussions or removing voting rights of specific members.
- (4) Persons that are directly involved in the provision of the benchmark may sit on the oversight function in a non-voting capacity as they can provide useful insight into the work of the administrator. Their status as non-voting members is appropriate to ensure that the administrator does not hold undue influence over the decisions of the oversight function.

¹ OJ L 171, 29.6.2016, p. 1

- (5) The oversight function can include committees with specific, dedicated competencies, for different benchmarks or families of benchmarks or it can include multiple functions carrying out different tasks when persons with appropriate expertise cannot all sit on one committee, for example when they are based in different geographical regions. Those oversight functions need to have a single natural person or a committee in charge of the direction of the oversight function and responsible for interaction with the management body of the administrator and with the competent authority to facilitate the centralisation of oversight.
- (6) For some lesser used and less vulnerable significant benchmarks, it may be possible for a single natural person to act as the oversight function, where the natural person can commit an appropriate amount of time to the oversight of the relevant benchmarks. Where the oversight function is a natural person, it is exempt from certain procedures which are only appropriate for a committee. Due to the high degree of use of critical benchmarks and the risks they might cause in certain instances, critical benchmarks should not be overseen by a natural person.
- (7) To fulfil the responsibilities of the oversight function, members need to have expert knowledge of the benchmark provision process but also of the underlying market that the benchmark seeks to measure. Such expertise may be sourced from users and contributors active in the markets or from providers of regulated data. An oversight function may benefit from the expertise of contributors, as long as appropriate measures are taken to ensure the absence of conflicts of interest, and users have an interest in ensuring the benchmark is robust. It is therefore appropriate that contributors and users be considered as members for such benchmarks.
- (8) The oversight function is an essential tool for managing conflicts of interest at the level of the administrator and in order to ensure the integrity of the function, persons that have been sanctioned for breaches of rules on financial services, in particular manipulation or attempted manipulation under Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC², should be prohibited from becoming members of an oversight function.
- (9) External stakeholders can have an interest in the benchmark where it is widely used in their markets and they can provide additional expertise. Administrators may establish procedures that allow for them to participate as observers to the oversight function.
- (10) Independent committees cannot be completely separated from the organisation of the administrator as the final decisions with regards to the business of the administrator lie with the management body, and a separate committee could take decisions without fully appreciating the potentially detrimental impact of such decisions on the business of the administrator. An oversight function embedded within the organisation of the administrator, or of the parent company of the group to which it belongs to, is therefore best placed to challenge the decisions of the administrator with respect to the benchmarks it provides.
- (11) In order for the oversight body to perform its function assigned to it by Regulation (EU) 2016/1011, it is important that it has the ability to fully assess and to challenge the decisions of the management body of the administrator and that, in case of a disagreement, the deliberations of the oversight function in this regard are recorded.

² OJ L 173, 12.6.2014, p. 1.

- (12) Procedures on the criteria for selection of members and observers, on conflicts of interest management and, in case the oversight function is a committee, procedures covering dispute resolution are necessary to ensure that the oversight function can operate without impediment. There may be other procedures appropriate to the oversight function for certain types of benchmarks or administrators which are not set out in this Regulation but are necessary and appropriate for the correct governance of their benchmarks. Administrators may therefore introduce alternative procedures provided that those procedures achieve the appropriate level of oversight.
- (13) This Regulation is based on the draft regulatory technical standards submitted by the European Securities and Markets Authority (ESMA) to the Commission.
- (14) ESMA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Securities and Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1095/2010³.
- (15) Administrators should be given sufficient time to ensure compliance with the requirements of this Regulation. This Regulation should therefore start to apply two months after it enters into force,

HAS ADOPTED THIS REGULATION:

Article 1
Composition of the oversight function

1. The structure and composition of the oversight function shall be proportionate to the ownership and control structure of the administrator and shall, as a general rule, be determined in accordance with one or more appropriate governance arrangements listed in the Annex to this Regulation. Administrators shall provide competent authorities with a justification for any deviation from such arrangements.
2. Where the benchmark is a critical benchmark, the oversight function shall be carried out by a committee with at least two independent members. Independent members shall be natural persons sitting on the oversight function who are not directly affiliated with the administrator other than through their involvement in the oversight function, and shall have no conflicts of interest, particularly at the level of the relevant benchmark.
3. The oversight function shall be composed of members who together have the skills and expertise appropriate to the oversight of the provision of a particular benchmark and to the responsibilities that the oversight function is required to fulfil. Members of the oversight function shall have appropriate knowledge of the underlying market or economic reality that the benchmark seeks to measure.
4. Administrators of regulated-data benchmarks shall include, as members of the oversight function, representatives from the entities listed in the definition of a regulated-data benchmark at point (a) of Article 3(1)(24) of Regulation (EU) 2016/1011 and, where applicable, from entities contributing net asset values of investment funds to regulated-data benchmarks. Administrators shall provide

³ Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

competent authorities with a justification for any exclusion of representatives from these entities.

5. Where a benchmark is based on contributions and representatives of its contributors or of supervised entities that use the benchmark are members of the oversight function, the administrator shall ensure that the number of members with conflicts of interest does not amount to or exceed a simple majority. Before the appointment of members, administrators shall also identify and take into account the conflicts arising from relationships between potential members and other external stakeholders, in particular resulting from a potential interest at the level of the relevant benchmarks.
6. Persons directly involved in the provision of the benchmark that may be members of the oversight function, shall have no voting rights. Representatives of the management body shall not be members or observers but may be invited to attend meetings by the oversight function in a non-voting capacity.
7. Members of the oversight function shall not include persons who have been subject to sanctions of administrative or criminal nature relating to financial services, in particular manipulation or attempted manipulation under Regulation (EU) 596/2014.

Article 2

Characteristics and positioning of the oversight function

1. The oversight function shall constitute a part of the organisational structure of the administrator, or of the parent company of the group to which it belongs, but be separate from the management body and other governance functions of the benchmark administrator.
2. The oversight function shall assess, and where appropriate challenge, the decisions of the management body of the administrator with regards to benchmarks provision to ensure the fulfilment of the requirements of Regulation (EU) 2016/1011. Without prejudice to point (i) of Article 5(3) of Regulation (EU) 2016/1011, the oversight function shall address all recommendations on benchmark oversight to the management body.
3. Where the oversight function becomes aware that the management body has acted or intends to act contrary to any recommendations or decisions of the oversight function, it shall record that fact clearly in the minutes of its next meeting, or in its record of decisions where an oversight function has been established in accordance with the third governance arrangement set out in the Annex to this Regulation.

Article 3

Procedures governing the oversight function

1. An oversight function shall have procedures at least relating to the following areas:
 - (a) its terms of reference, the frequency of its regular meetings, the recording of minutes of the meetings and of its decisions and the periodic information sharing with the management body of the administrator;
 - (b) the criteria to select its members, including criteria to evaluate the potential members' expertise, skills and whether they can meet the time commitments required. Those criteria shall take into account in particular potential members' role in any other oversight function;

- (c) the criteria to select observers who may be permitted to join a meeting of the oversight function;
- (d) the election, nomination or removal and replacement of its members;
- (e) where applicable, the criteria for choosing the person or committee responsible for its overall direction and coordination and for acting as the contact point for the management body of the administrator and for the competent authority, in accordance with the appropriate governance arrangements for oversight functions consisting of multiple committees as set out in the Annex;
- (f) the public disclosure of summary details of its members, along with any declarations of conflicts of interest and of any measures taken to mitigate them;
- (g) the suspension of voting rights of external members for decisions that would have a direct business impact on the organisations they represent;
- (h) requiring members to disclose any conflict of interest before discussion of an agenda item during meetings of the oversight function and their recording in the minutes of the meeting;
- (i) the exclusion of members from specific discussions in respect of which they have a conflict of interest and the recording of the exclusion in the minutes of the meeting;
- (j) its access to all documentation necessary to carry out its duties;
- (k) the management of disputes within it;
- (l) measures to be taken in respect of breaches of the code of conduct;
- (m) the notification to the competent authority of any suspected misconduct by contributors or by the administrator and of any anomalous or suspicious input data;
- (n) the prevention of improper disclosure of confidential or sensitive information received, produced or discussed by the oversight function.

2. Where the oversight function is carried out by a natural person:

- (a) Points (e), (g), (i), and (k) of paragraph 1 do not apply;
- (b) the administrator shall appoint an alternate appropriate body or natural person to ensure that duties of the oversight function can be consistently carried out in case of the absence of the person responsible for the oversight function.

Article 4 *Entry into force*

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

It shall apply from [OJ: please insert date 2 months after the date of entry into force].

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 13.7.2018

*For the Commission
The President
Jean-Claude JUNCKER*