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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union

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Delegations will find attached document C(2021) 3143 final.

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EUROPEAN
COMMISSION

Brussels, 6.5.2021
C(2021) 3143 final

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

of 6.5.2021

supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council with regard to regulatory technical standards specifying the conditions to ensure that the methodology for determining a benchmark complies with the quality requirements

(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 12 of Regulation (EU) 2016/1011 (BMR) as amended by Regulation (EU) 2019/2175. 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) 1095/2010 ESMA has carried out a public consultation on the draft regulatory technical standards. A consultation paper was published on 9 March 2020 on the ESMA website and the consultation closed on 8 June 2020. An open hearing on the consultation paper was held on 29 May 2020 via conference call. On 29 September 2020, ESMA published a final report including the draft technical standards. In addition, ESMA requested the opinion of the Securities and Markets Stakeholder Group (SMSG) established in accordance with Article 37 of Regulation (EU) No 1095/2010. 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.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

The right to adopt regulatory technical standards is provided for under Article 12(4) of Regulation (EU) No 2016/1011 (BMR) as amended by Regulation (EU) 2019/2175. Under this provision, the Commission is empowered to further specify the conditions to ensure that the benchmark methodology preserves the integrity of the benchmark itself.

Article 1 specifies the conditions to ensure that the methodology is robust and reliable.

Article 2 specifies the conditions to ensure that the methodology has clear rules identifying how and when discretion may be exercised in the determination of the benchmark.

Article 3 specifies the conditions to ensure that the methodology is rigorous, continuous and capable of validation including, where appropriate, back-testing against available transaction data.

Article 4 specifies the conditions to ensure that the methodology is resilient and ensures that the benchmark can be calculated in the widest set of possible circumstances, without compromising its integrity.

Article 5 specifies the conditions to ensure that the methodology is traceable and verifiable.

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

of 6.5.2021

supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council with regard to regulatory technical standards specifying the conditions to ensure that the methodology for determining a benchmark complies with the quality requirements

(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 12(4) thereof,

Whereas:

- (1) For the methodology for determining a benchmark to be robust and reliable, that methodology should specify the nature of the input data used and any criteria to be applicable in circumstances in which the quantity or quality of input data falls below the standards necessary for the methodology to determine the benchmark accurately and reliably, it should be subject to an assessment of the relationship between the key assumptions used and the sensitivity of the benchmark computed by that methodology, it should be capable of representing the underlying market or economic reality that it seeks to measure and it should incorporate factors including parameters and input data that are most relevant to measure the underlying market.
- (2) A benchmark is calculated using a formula or other method of calculation based on underlying values. Administrators have a degree of discretion in constructing the formula, in performing the necessary calculation and in determining the input data. That degree of discretion creates a risk of manipulation. Administrators should therefore ensure that when such discretion is used, an appropriate control system is in place. Regulation (EU) 2016/1011 recognises that the construction of a benchmark methodology might embed discretion exercised by each administrator. It is important that the methodology includes clear rules identifying how and when that discretion is allowed to be exercised and in particular whether that discretion is based on an algorithm or pre-defined methodology. Furthermore, the methodology should clarify in which circumstances transaction data in the underlying market would be considered as not sufficient.

¹ OJ L 171, 29.6.2016, p. 1.

- (3) It is important that an administrator is able to construct a benchmark methodology that is resilient to different market conditions and that allows for the calculation of the benchmark in the widest set of possible market circumstances. The benchmark methodology used should therefore rely on adequate and appropriate historical values of the benchmark. For the same reason, and in particular to validate the calculation of the benchmark and to evaluate the performance of the methodology *ex post*, the benchmark methodology should be back-tested against available transaction data. Such back-testing should be an *ex post* exercise, which either uses additional available data that were not used for the calculation of the benchmark or other sources of transaction data, or reconstructs the historical values of the benchmark. To ensure that the benchmark methodology is capable of validation, it is important that back-testing is performed both at each annual review of the benchmark methodology and, depending on the type of the benchmark, either after each material change of that methodology, on an ongoing basis, or at the first provision of the benchmark. The findings from the back-testing should be reflected in the methodology.
- (4) A benchmark methodology that is resilient should be able to be used for the calculation of the benchmark in the widest set of possible circumstances, including in stressed market conditions. It is therefore important that administrators assess the impact of various market conditions on the methodology using historical data from realised stressed market conditions, and that for critical benchmarks, hypothetical data for unrealised stressed market conditions are used.
- (5) A benchmark methodology that is traceable and verifiable should allow for a continuous check and control of each calculation of the benchmark. Traceability should include the documentation of the different steps of the methodology and should be the basis for verifiability that would imply the ability to reconstruct the historical values of the benchmark.
- (6) In accordance with the principle of proportionality, administrators of non-significant benchmarks and of regulated-data benchmarks should not be subject to an excessive administrative burden. It is therefore appropriate that such administrators should be able to opt out from certain quality requirements for those benchmarks. In addition, where it is justified in view of the nature, scale and complexity of their activities, the likelihood of a conflict of interest arising between the provision of the benchmark and any other activities of the administrator, and the level of discretion involved in the process of provision of the benchmark, certain benchmark administrators should be able to opt out from certain requirements regarding the resilience of the methodology of the benchmark.
- (7) This Regulation is based on the draft regulatory technical standards submitted to the Commission by the European Securities and Markets Authority (ESMA).
- (8) 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 advice of the Securities and Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council².

² 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).

- (9) In order to ensure consistency with the date of application of Article 5 of Regulation (EU) 2019/2175 of the European Parliament and of the Council³, which introduced in Regulation (EU) 2016/1011 Article 12(4) of that Regulation, this Regulation should apply from 1 January 2022,

HAS ADOPTED THIS REGULATION:

Article 1

Conditions to ensure that the benchmark methodology is robust and reliable

1. A benchmark methodology as referred to in Article 12(1), point (a), of Regulation (EU) 2016/1011, shall:
 - (a) be capable of representing the underlying market or economic reality that it seeks to measure and shall incorporate factors, including parameters and input data, that are most relevant to measure the underlying market;
 - (b) be subject to an assessment of the relationship between the key assumptions used and the sensitivity of the benchmark computed by that methodology;
 - (c) specify the nature of the input data used in the methodology;
 - (d) specify any criteria to be applicable in circumstances in which the quantity or quality of input data falls below the standards necessary for the methodology to determine the benchmark accurately and reliably.
2. Administrators of non-significant benchmarks may choose not to apply paragraph 1, point (b), for those benchmarks .
3. Administrators of regulated-data benchmarks may choose not to apply paragraph 1, points (b) and (c), for those benchmarks .

Article 2

Conditions to ensure that the benchmark methodology has clear rules identifying how and when discretion may be exercised in the determination of the benchmark

A benchmark methodology as referred to in Article 12(1), point (b), of Regulation (EU) 2016/1011 shall specify all of the following:

- (a) the step of the calculation of the benchmark at which discretion is performed;

³ Regulation (EU) 2019/2175 of the European Parliament and of the Council of 18 December 2019 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority), Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority), Regulation (EU) No 600/2014 on markets in financial instruments, Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds, and Regulation (EU) 2015/847 on information accompanying transfers of funds (OJ L 334, 27.12.2019, p. 1).

- (b) the criteria that are to be used when exercising the discretion;
- (c) the input data that are to be taken into account;
- (d) where applicable, a non-exhaustive list of the conditions under which:
 - (i) transaction data in the underlying market are to be considered as not sufficient and the use of transaction data in related markets is needed;
 - (ii) applying the methodology does not yield a result and discretion has to be exercised in the determination of the benchmark.
- (e) the type of related markets that are to be considered appropriate for the purposes of point (d)(i).

Article 3

Conditions to ensure that the benchmark methodology is rigorous, continuous and capable of validation including, where appropriate, back-testing against available transaction data

1. A benchmark methodology as referred to in Article 12(1), point (c), of Regulation (EU) 2016/1011 shall contain all of the following:
 - (a) an assessment of the adequacy and appropriateness of the historical values of the benchmark produced by that methodology;
 - (b) reliable input data, including appropriate size of the data samples, if any;
2. Benchmark administrators shall ensure that any back-testing to which the benchmark methodology is subject takes place *ex post* and refers to an appropriate time horizon.

Back-testing shall take place at least at each annual review of the benchmark methodology and following any material change of that methodology. For regulated-data benchmarks, back-testing shall take place at the first provision of the benchmark. For critical benchmarks, a monthly back-testing shall be performed.

The benchmark methodology shall include an assessment of the back-testing results, including processes to ensure that systemic anomalies highlighted by back-testing are identified and properly addressed.

Article 4

Conditions to ensure that the benchmark methodology is resilient and ensures that the benchmark can be calculated in the widest set of possible circumstances, without compromising its integrity

1. Administrators shall assess the impact of various market conditions on the methodology using historical data from stressed market conditions. Where no appropriate historical data are available, administrators of critical benchmarks shall use hypothetical data representing stressed market conditions.

2. Administrators shall use parameters and assumptions in the methodology to capture a variety of historical or, in the case of administrators of critical benchmarks, hypothetical conditions, including the most volatile periods experienced by the markets and taking into account a variety of hypotheses for correlation between underlying assets.
3. Administrators of non-significant benchmarks and regulated-data benchmarks may choose not to apply paragraph 2 with respect to those benchmarks.
4. Administrators may choose not to apply any of the requirements laid down in paragraphs 1 and 2, having regard to the following matters:
 - (a) the nature, scale and complexity of the provision of the benchmarks;
 - (b) the likelihood of a conflict of interest arising in the provision of the benchmarks;
 - (c) the level of discretion involved in the process of provision of benchmarks.

Article 5

Conditions to ensure that the benchmark methodology is traceable and verifiable

Benchmark administrators shall keep a documented audit trail of the calculation of the benchmark, including any assessment of the resilience of the methodology and the back-testing results.

Article 6

Entry into force and application

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 1 January 2022.

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

Done at Brussels, 6.5.2021

For the Commission
The President
Ursula VON DER LEYEN