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ESMA: Rules for Third Country Benchmarks Are Not Fit for Purpose and Should Be Reviewed

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On August 19, the European Securities and Markets Authority ("ESMA") announced the publication of its response to a consultation on the European Commission's (the "Commission") proposals to amend the regime for the provision of "third country" (meaning non-EU) benchmarks into the EU under the Benchmarks Regulation ("BMR"). The Commission's consultation, which concluded on August 12, 2022, asked for views on whether the rules applicable to the use of benchmarks administered in a third country, which will fully enter into application in January 2024, are fit for purpose and if not, how should the BMR's third country regime be amended. The BMR entered into force in January 2018, however the use of non-BMR compliant third country benchmarks in the EU is still permitted until December 31, 2023 under transitional arrangements.

In its response, ESMA states that its own research has found that there are 330 third country administrators providing benchmarks available to supervised entities in the EU, out of which 3% (*i.e.*, 11) are already authorized to be used in the EU under one of the third country regimes (recognition or endorsement under the BMR). The response goes on to note that 20% of the 330 are exempted in accordance with the BMR's scope provisions, while the remaining 77% of those third country administrators provide benchmarks that are not yet subject to the regulation. ESMA concludes that should "administrators not apply for recognition or endorsement before the expiration of the transitional period, hundreds of thousands of benchmarks will not be accessible anymore to EU supervised entities and thus for use in the EU, which could be detrimental to the functioning of the EU financial markets."

ESMA expects that the larger third party administrators based in third countries would be willing to apply in the EU and that this would "include more likely the UK-based administrators, which were already subject to BMR before the UK left the EU." However, ESMA expresses uncertainty that small or medium administrators would apply for recognition or endorsement before the expiration of the transition period. ESMA said that, in such a scenario, while the extent of the use of these benchmarks is not entirely clear, it was evident that EU supervised entities will no longer have access to the widest range of third country benchmarks.

The Commission's consultation also requested views on a potential framework under which only certain third country benchmarks deemed "strategic" would remain subject to restrictions of use similar to the current rules. ESMA stated it was "somewhat in favour" of the proposal and that it

would have been “totally in favour” if the level playing field between EU and third country administrators were ensured. ESMA also expressed the view that it should be the agency entrusted with supervision of “strategic” third country benchmarks.

ESMA are in agreement with the Commission that the creation of an EU ESG benchmark label would be a supporting tool against greenwashing and that sufficiently ambitious minimum standards for the methodology should be considered to offer reassurances as to the sustainability-related impact of such benchmarks.

ESMA suggested to the Commission that further analysis should be carried out to avoid unintended consequences if the legislation is amended. They offer the example that “to avoid excessive complexity of the regulatory framework, ESMA suggests reconsidering the several other categories of benchmarks currently identified by the BMR with the aim to simplify the regulatory framework.” Furthermore, ESMA stated that, in its view, the introduction of strategic benchmarks would render the two categories of “significant” and “non-significant”’ under the BMR unnecessary. However, as the “critical” benchmarks category is linked to additional BMR requirements, this category should be maintained.

The Commission’s consultation and the ESMA response reflect the fact that while BMR covers a wide range of benchmarks used by supervised entities in the EU, so far very few third country jurisdictions have followed a similar regulatory approach regarding the provision and use of benchmarks. When the Commission eventually proposes amendments to the third country regime in the BMR, it will be critical to strike a balance between minimizing the market impact of potentially removing the ability to permit EU institutions to use thousands of benchmarks administered in a third country, while not providing a competitive advantage to those third country administrators by exempting them from many or all of BMR requirements. The definition of a “strategic” benchmark will be a key part of this balancing act.

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