

A banner for a workshop series featuring various hand tools like hammers, chisels, and a saw arranged on a wooden workbench. The word 'REVERSE' is in large red letters, 'inquiries' is in white, and 'Workshop Series' is in a black cursive font. A red box contains the text 'IN-DEPTH SESSIONS' and the date 'February 11, 2021' is centered below it.

REVERSE inquiries

Workshop Series

IN-DEPTH SESSIONS

February 11, 2021

Proprietary Indices, US and European Considerations

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Agenda

- What is an index?
- Compliance aspects
- Disclosure issues
- Rule-based indices
- Index governance and index rules
- Removing stocks from an index
- Discretion, the Advisers Act, and tax considerations
- Index descriptions and rulebooks
- Conflicts of interest and the IOSCO and ESMA guidance
- European benchmark regulation

What makes an index an index?

Indices

What is an index?

- Structured products are often linked to proprietary or novel indices. Proprietary indices may raise issues under the Securities Act of 1933, the Investment Company Act of 1940 and the Investment Advisers Act of 1940 (“IAA”)

General issues to consider

- Is the index created by the issuer or an affiliate (“proprietary”) or by a third party?
- Will there be adequate disclosure about the index and its methodology?
- Are there elements of discretion in the index, thus raising IAA issues?
- How does the index compare against a “benchmark,” such as the NYSE generic listing rules?

Proprietary indices

- If an affiliate of the investment bank, or a group within the investment bank, creates or maintains the index, then that index provider must be walled off from those who structure and market the product
- Those who create and market the structured product cannot influence the index features or its components
- NYSE Arca Equity Rule 5.2E(j)(6)(C): “If the value of an Index-Linked Security listed under Rule 5.2E(j)(6) is based in whole or in part on an index that is maintained by a broker-dealer, the broker-dealer shall erect a ‘firewall’ around the personnel responsible for the maintenance of such index or who have access to information concerning changes and adjustments to the index, and the index shall be calculated by a third party who is not a broker-dealer”
- A separate group within the investment bank should be responsible for any index development
- Who “owns” the index within the investment bank once it has been created?

Proprietary indices – window cleaning

- **Window cleaning**

- If the index concentrates in a few equity securities (i.e., a “narrow-based” index), the issuer of the product and the broker-dealer selling the product should perform “window cleaning” procedures
 - Window cleaning procedures are comparable to those used when issuing a product linked to a small basket of stocks, or when linking to a non-proprietary index that has a high concentration in a particular security (the percentage amount may be anywhere from 5% to 20%)
 - These procedures should prevent the issuance of a product linked to a security with respect to which the broker-dealer possesses material non-public information, or as to which the broker-dealer’s research arm has a negative rating or recommendation
 - Concerns diminish somewhat when there are a large number of index constituents
- The “window cleaning” function or filter should not be written into the index but rather should be a step that is required by the firm’s compliance policies and procedures
 - For example, do not include as an index rule checking whether index constituent is the subject of research coverage

Third-party indices

- If the index is generated by a third-party provider
 - Perform diligence on the third-party provider
 - Does the provider have sufficient experience?
 - Does the provider periodically conduct internal reviews to ensure that the index methodology is consistently and accurately applied?
 - What is the index's history?
 - Is the third-party provider a regulated entity?
 - To the extent the third party is itself a broker-dealer or an RIA, compliance and diligence process likely will be more easily addressed
 - If the provider is not a broker-dealer or an RIA, what exceptions from registration is it relying on?
 - How is the provider being compensated?

Third-party indices *(cont'd)*

- Ensure that the index sponsor has protections in place against the misuse of material, nonpublic information
 - NYSE Arca Equity Rule 5.2E(j)(6)(C): “Any advisory committee, supervisory board or similar entity that advises an index licensor or administrator or that makes decisions regarding the index or portfolio composition, methodology and related matters must implement and maintain, or be subject to, procedures designed to prevent the use and dissemination of material, non-public information regarding the applicable index or portfolio”
- Will the third party be the index sponsor, or play any other role? For example, is it also the calculation agent?
- Diligence whether the provider has complied or intends to comply with the IOSCO standards and the European benchmark regulations to the extent applicable
- Will a license be required to reference the index?

Narrow versus broad-based index

- NYSE Arca Rule 5.2E(j)(6): Equity Index-Linked Securities, Commodity-Linked Securities, Currency-Linked Securities, Fixed Income Index-Linked Securities, Futures-Linked Securities and Multifactor Index-Linked Securities
 - SEC has approved certain “generic” NYSE listing rules
 - Equity Index-Linked criteria for indices (summarized)
 - Minimum of ten constituents
 - Minimum market value per component of at least \$75 million
 - Minimum monthly trading volume
 - No single component can be more than 25% of the dollar weight of the index, and the five highest dollar-weighted components cannot exceed 50% of the dollar weight (60% for an index of fewer than 25 components)
 - 90% of the index’s weight and at least 80% of the number of components must be eligible for standardized option trading on the NYSE. *Requirement doesn’t apply if:*
 - No underlying component represents more than 10% of the dollar weight of the index; and
 - The index has a minimum of 20 components
 - General themes
 - Indices with more than 20-25 components are subject to fewer requirements
 - Avoid top-heavy indices
 - Actively traded components

Regulatory hot buttons

- FINRA Report on Conflicts of Interest
 - Focuses on potential conflicts arising when an index calculation agent is an affiliate of the issuer or the underwriter
 - Highlights that in the context of a structured product the performance of which is linked to a proprietary index (created and maintained by the product issuer) there may be hidden costs, which may be high and may be difficult for an investor to assess
 - Assessing the structure and composition of the index has become a focus in SEC enforcement actions
 - Are there any “index adjustment factors” or “fees” that might suggest that the index is a managed index?
 - Are there other “embedded” fees?
 - If there are roll costs or transaction costs incorporated in the index that are designed to replicate cost of investing in the strategy directly, then confirm that those costs do not include any broker-dealer compensation
 - If there are costs incorporated into the index that are intended to account for hedging, then ensure that mid-market prices are used

Regulatory hot buttons *(cont'd)*

- Convergence concerns
 - Over time, there has been more blurring of lines as between product types
 - Traditional 1940 Act products and “managed accounts”
 - ETFs
 - 1933 Act products, where there is a security (not an investment company and no “ongoing management”)
 - Monitor how the product is marketed and how the product is discussed internally
 - Ensure that there is no “active” management

Index governance

- Consider, among other things, the following:
 - Formalizing in policies and procedures the approval process for a new index
 - Review existing indices
 - Identify who “owns” the index within the bank
 - Ensure that there is a process for periodic index reviews
 - Is there a written index methodology? Who reviews and maintains?
 - Do policies and procedures address changes to the index, consultation regarding index changes and publication of changes, etc.?
 - Is there a policy in place to ensure any quotes or pricing data is obtained from third party sources? Is this audited or reviewed?
 - If internal sources are used for pricing purposes, is this disclosed?
 - Is there a third party calculation agent?
 - Is there written calculation agreement?

Index governance *(cont'd)*

- Is there a stated purpose for the index? How is the index used? Is it used to benchmark performance of funds? To replicate a strategy?
- Was the index created at the request of a client? Does client maintain any discretion over the index?
- Are the appropriate information walls in place? Are these tested?
- Have all of the actual/potential conflicts of interest been identified and disclosed?

Disclosure issues

- Generally, the index methodology should be publicly available
- A link to the methodology is recommended (but not live!)
 - A detailed methodology is essential if the index were to be transferred to another sponsor; the methodology will ensure continuity
 - Opaque methodologies with formulae:
 - Translate into plain English
 - How to summarize — risk of error
 - Include complex formulae in the offering document?
 - Roles: index sponsor, calculation agent, information dissemination
 - Disclose any conflicts of interest
 - Are there similar indices to compare against, with appropriate disclosure as to the differences?
 - Quarterly high and low closing levels of the index and the daily closing level should be publicly available free of charge at the close of business on each trading day

Disclosure issues – equity indices

- General equity index information, summarized from the methodology:
 - Method of calculation
 - Name of calculation agent
 - A list of the top ten constituents and all constituents representing 5% or more of the weighting of the index, and their respective weightings and, if available, a link to a list of all of the constituents
 - How the constituents were chosen, and how new constituents are selected
 - Index changes and reweightings/rebalancings: when and how?
 - How does the index account for corporate events (mergers, etc.) and how does it factor in market disruption events?
 - If the index contains constituents from multiple industries or sectors and constituents have been classified accordingly by the index sponsor, what are the industry or sector weightings? Similarly, any country weightings?

Disclosure issues – Commodities indices

- General commodities index information (indices of physical commodities or commodities futures), summarized from the methodology:
 - Describe constituents — Physical commodities, commodities futures or options to purchase commodities, and the markets on which they trade
 - List the top ten constituents, and all constituents representing 5% or more of the weighting of the index, and their respective weightings and, if available, a link to a list of all of the constituents
 - Describe the method by which the constituents were chosen or obtained
 - Describe when and under what circumstances the constituents may be changed, reweighted, substituted or traded, as applicable
 - Describe any rolling periods
 - Summarize any fees or expenses charged or incurred by the index sponsor

Executive Order 13959 – Chinese Military Companies Sanctions

- The Executive Order bans investments by U.S. persons in publicly traded securities of Chinese Communist military companies (“CCMCs”), or securities that are derivative of, or designed to provide investment exposure to, such securities.
- S&P Dow Jones Indices and FTSE Russell removed constituents that are CCMCs from their respective indices on December 21, 2020. Removals from the MSCI Indices became effective on January 5, 2021.
- Hang Seng Indexes Co., sponsor of Hang Seng Index, has not announced compliance with the Executive Order.
- Which securities are affected? A non-exclusive list:
 - A structured note linked to either a CCMC security, an index including a CCMC security or an ETF linked to an index including a CCMC security
 - No de minimis exception

How are note holders affected?

- Transactions by U.S. persons in publicly traded securities, or securities derivative of, or designed to provide investment exposure to, securities of designated CCMCs, are banned, starting on January 11, 2021, except to divest;
 - **Example:** A structured note linked to an index including CCMC securities
- Possession by U.S. persons of existing publicly traded securities, or securities derivative of, or designed to provide investment exposure to, securities of designated CCMC securities after November 11, 2021 is banned;
- If a Chinese issuer is in the future determined to be a CCMC, possession of publicly traded securities, or securities derivative of, or designed to provide investment exposure to, such CCMC by a U.S. person would be prohibited 365 days after the date of such determination; and
- Any transaction in CCMC securities or a structured note linked to a CCMC security, solely to divest, is permitted prior to the respective cut-off date for ownership.

Investment Company Act issues

- Investment Company Act (“ICA”) considerations
 - Would the SEC recharacterize the structured product itself as an unregistered investment company (a “de facto” investment company)?
 - Is the pool of reference assets itself a separate issuer?
 - *Prudential Insurance* case – Separate accounts
 - Cannot do indirectly what you cannot do directly

Investment Company Act issues *(cont'd)*

- Avoiding ICA issues in Delta One instruments
 - **Delta One instruments:** Structured products that are unsecured debt obligations of issuer - return is linked to a reference asset
 - Does the investor's return rely exclusively on credit of issuer?
 - Does return depend on investment in identifiable pool of securities?
 - Is the issuer required to own reference assets in order to provide the return?
 - Does the issuer "control" reference assets?
 - Does investor's return depend on the issuer's ability to manage the investment?
 - Is a structured product linked to tailored or narrow-based index as an indirect means to construct a managed portfolio?
 - Are issuer's investments to hedge its obligations held in issuer's general assets or segregated account?
 - Narrow-based versus broad-based index?
 - Does the index involve investment discretion?
 - Static baskets of equities or commodities, even if initially selected based on a particular strategy, do not, in our view, present discretion issues
 - A research-driven index may involve discretion; however, determination will be fact-specific

Investment Company Act issues *(cont'd)*

- Avoiding ICA issues in Delta One Instruments
 - **Core issue:** Look at substance of structured product and its terms, as well as the rights of the holder of the structured product, rather than number of securities that comprise the referenced index

Investment Advisers Act issues

- Avoiding IAA issues
 - Index that involves discretion raises issues under IAA
 - Does structured product resemble “investment advice”?
 - Is broker-dealer sponsor of structured product acting as an investment adviser in the context of offering a product referencing the index?
 - Can broker-dealer rely on “broker-dealer” exemption from definition of investment adviser (Section 202(a)(11)(C) of IAA)?
 - Provides advice (the sale of the note or the swap) that is “solely incidental” to its role as a broker or dealer
 - Is broker-dealer’s principal role structuring the note? distributing the note?
 - Receives no compensation for its services (i.e., no “special” advisory fee or index fee) that would suggest that broker-dealer is actively managing a strategy
 - Is the index a rules-based index?

Investment Advisers Act issues *(cont'd)*

- Can an entity that is not a broker-dealer or investment adviser rely on the publisher's exception from registration?
 - "Today, funds track indexes in a huge number of varieties. Some indexes focus on narrower strategies. Others use alternative weighting methods, like those for "smart beta" funds. In some cases, funds track custom indexes or indexes from an affiliated provider.
 - These changes appear to reflect the progression of a maturing market for index products, and I am sure we will continue seeing innovation. As market practices around indexes change, however, should we revisit the status of certain index providers as investment advisers? I understand that the question of whether an index provider is an investment adviser or a fund adviser might appear to be settled. Under the Advisers Act, I believe index providers have historically concluded that, even if they are investment advisers, they may rely on the publisher's exclusion from the definition of "investment adviser." However, recent developments appear to have moved certain index providers away from what we might think of as publishers."

IAA issues – Other questions to consider

- **The integrity of the index:** Consider separating the roles of the personnel who develop the index and any sales and marketing personnel. Any index should be subject to a governance and oversight and supervisory process. If this is case, then one ought to conclude that the principal role of the broker-dealer selling the Delta-One Instrument is limited to structuring the financial product and selling the financial product, not providing advice as a function of participating in the construction of the index or the selection of the index constituents.
- **The purpose of the index:** Evaluate the role and purpose of the index. Is there a business purpose or objective served by the creation of the index? For example, was the index created to serve as a benchmark for funds tracking their performance? Does the index embody an investment thesis? In practice, over the history of the index, has the index reflected that investment strategy? An index that was generated at the request of a structured products or swaps business group and used as a reference asset would raise concerns.
- **The role of the broker-dealer:** Is the broker-dealer advising indirectly on the merits of the underlying index constituents simply by selling a Delta-One Instrument referencing that index? This would seem unlikely. The relevant transaction documents usually expressly inform the investor whether this is the case. We believe that statements in transaction documentation would be respected.
- **Business element:** In the context of selling the Delta-One Instrument, is the broker-dealer holding itself out as rendering advice on the index or any index constituent? Is it receiving a separate commission or a fee or compensation that is specific to an “advice” component?
- **Regular business of the broker-dealer:** If there arguably is an element of advice in connection with the broker-dealer’s sales of the financial product, is it solely incidental to the conduct of its business as a broker-dealer?

What does a tax adviser see in an index?

- The tax adviser is trying to determine whether the index should be viewed as a standalone investment or as an investment in the underlying securities for federal income tax purposes.
- Tax consequences to investors in index-based derivatives can vary widely depending on index composition and mechanics.
- Therefore, to ensure the client achieves the desired tax result, the tax adviser needs to know how the index is calculated.

Dividend equivalent withholding

- As a reminder, Section 871(m) and its regulations impose a 30% U.S. withholding tax on U.S.-source “dividend equivalent” amounts – a dividend equivalent includes:
 - Any substitute dividend made pursuant to a securities-lending or “repo” transaction
 - Any amount paid pursuant to a “specified notional principal contract” and that is contingent on, or determined by reference to, the payment of a U.S.-source dividend
 - Any amount that the Treasury determines is substantially similar to the above items
 - Specified equity-linked instruments (*e.g.*, structured notes)

A derivative based on a qualified index is exempt from Section 871(m)

- Safe harbor in Regulation Section 1.871-15(l) for “...certain passive indices that are based on a diverse basket of publicly-traded securities and that are widely used by numerous market participants.”
- Determine on first business day of relevant calendar year

Qualified index

- References 25 or more component securities
- Long only
- No component more than 15%
- Five or fewer can't represent more than 40%
- Rebalanced according to publicly stated, predefined criteria
- Annual dividend yield in prior year not greater than 1.5x S&P 500 annual dividend yield
- Traded through futures contracts or options on recognized exchange

Qualified index—de minimis rule

- Widely traded
- Only references “underlying securities” (*i.e.*, U.S. corporations) 10% or less (by weight)
- Index was not created for tax avoidance purposes

Exception for certain MLP indices

- The Section 871(m) regulations contain an exception for instruments linked to certain partnerships if the partnership does not
 - Carry on a trade or business of dealing or trading in securities
 - Hold a “significant investment” in U.S. securities or Section 871(m) transactions, generally defined to be 25% or more of the value of a partnership’s assets; or
 - Directly or indirectly hold an interest in a lower tier partnership that holds U.S. securities or Section 871(m) transactions

The basket contract problem

- At least one large investment fund for many years invested using “basket contracts.”
- The fund entered into a two year option over a “basket” of common stocks with a bank.
- The option designated a portfolio manager related to the fund. Over the course of two years, manager would change out components to make basket performance more profitable.
- The contract was designed so that the fund would not recognize gain or loss currently, and would receive long term capital gain at maturity, thus converting ordinary income and short-term capital gain into long-term capital gain.
- IRS did not like, see CCA 201547004.

Notice 2015-74: basket contract is a transaction of interest

- Taxpayer enters into contract with Counterparty where return based on performance of reference basket
- Contract has a term of more than one year
- Taxpayer or Taxpayer's Designee has exercised discretion to change assets in the basket or trading algorithm
- Taxpayer's tax return reflects a tax benefit, *e.g.*, deferral or conversion of short-term capital gain to long-term capital gain

Notice 2015-74: designee

- Taxpayer's agent under agency law
- Person compensated by Taxpayer for suggesting, requesting, or determining changes in the basket/algorithm
- Not a designee:
 - Investment adviser of, for example, a mutual fund whose securities included in the basket
 - Because of person's use of, payment of fee for, or authority to suggest changes in (i) a widely used and publicly quoted index based on objective financial information, or (ii) index that tracks a broad market or market segment

Notice 2015-74: taxpayer does not have discretion if

- Changes made according to objective instructions, operations or calculations disclosed at inception
- Taxpayer does not have a right to change the rules
- Exercise of routine judgment in administration of the rules is permitted
- Error correction is permitted
- Adjustments to respond to unanticipated events (*e.g.*, stock split, merger, etc.) permitted

Notice 2015-74: excluded contracts

- Contract is excluded if:
 - Contract is traded on (a) national securities exchange regulated by SEC or a domestic board of trade subject to CFTC jurisdiction, **or** (b) foreign exchange or board of trade subject to regulation by comparable regulator, **or**
 - Contract is treated as contingent payment debt instrument, subject to current inclusion of OID at comparable yield or as a variable rate debt instrument

Form **8886**

(Rev. March 2011)
Department of the Treasury
Internal Revenue Service

Reportable Transaction Disclosure Statement

OMB No. 1545-1800

Attachment
Sequence No. **137**

► Attach to your tax return.
► See separate instructions.

Name(s) shown on return (individuals enter last name, first name, middle initial) Identifying number

Number, street, and room or suite no. City or town State ZIP code

- A** If you are filing more than one Form 8886 with your tax return, sequentially number each Form 8886 and enter the statement number for this Form 8886 Statement number of
- B** Enter the form number of the tax return to which this form is attached or related
Enter the year of the tax return identified above
Is this Form 8886 being filed with an amended tax return? Yes No
- C** Check the box(es) that apply (see instructions). Initial year filer Protective disclosure

1a Name of reportable transaction

1b Initial year participated in transaction **1c** Reportable transaction or tax shelter registration number (see instructions)

- 2** Identify the type of reportable transaction. Check all boxes that apply (see instructions).
 Listed Contractual protection Transaction of interest
 Confidential Loss

3 If you checked box 2a or 2c, enter the published guidance number for the listed transaction or transaction of interest

4 Enter the number of "same as or substantially similar" transactions reported on this form

5 If you participated in this reportable transaction through a partnership, S corporation, trust, and foreign entity, check the applicable boxes and provide the information below for the entity(ies) (see instructions). (Attach additional sheets, if necessary.)

a Type of entity Partnership Trust Partnership Trust
 S corporation Foreign S corporation Foreign

b Name

c Employer identification number (EIN), if known

d Date Schedule K-1 received from entity (enter "none" if Schedule K-1 not received)

6 Enter below the name and address of each individual or entity to whom you paid a fee with regard to the transaction if that individual or entity promoted, solicited, or recommended your participation in the transaction, or provided tax advice related to the transaction. (Attach additional sheets, if necessary.)

a Name	Identifying number (if known)	Fees paid \$	State	ZIP code
Number, street, and room or suite no. City or town				

b Name	Identifying number (if known)	Fees paid \$	State	ZIP code
Number, street, and room or suite no. City or town				

- 7 Facts**
- a** Identify the type of tax benefit generated by the transaction. Check all the boxes that apply (see instructions).
 Deductions Exclusions from gross income Absence of adjustments to basis Tax Credits
 Capital loss Recognition of gain Deferral
 Ordinary loss Adjustments to basis Other
- b** Further describe the amount and nature of the expected tax treatment and expected tax benefits generated by the transaction for all affected years. Include facts of each step of the transaction that relate to the expected tax benefits including the amount and nature of your investment. Include in your description your participation in the transaction and all related transactions regardless of the year in which they were entered into. Also, include a description of any tax result protection with respect to the transaction.
.....
.....
.....
.....

8 Identify all individuals and entities involved in the transaction that are tax-exempt, foreign, or related. Check the appropriate box(es) (see instructions). Include their name(s), identifying number(s), address(es), and a brief description of their involvement. For each foreign entity, identify its country of incorporation or existence. For each individual or related entity, explain how the individual or entity is related. Attach additional sheets, if necessary.

a Type of individual or entity: Tax-exempt Foreign Related

Name Identifying number

Address

Description

b Type of individual or entity: Tax-exempt Foreign Related

Name Identifying number

Address

Description

EU Benchmark Regulation

Overview

- Benchmark Regulation (EU) 2016/1011 of 8 June 2016 (BMR)
- Amended by Regulation (EU) 2019/2089 of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks and
- To be amended the Regulation xxxx/xxxx amending Regulation (EU) 2016/1011 as regards the exemption of certain third-country spot foreign exchange benchmarks and the designation of replacements for certain benchmarks in cessation, and amending Regulation (EU) 648/2012; not yet published in the Official Journal of the European Union
- Level II Provisions: 23 Delegated and Implementing Regulations (DA/IA/RTS/ITS)
(https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/benchmarks-regulation-level-2-measures-full_en.pdf)

EU Benchmark Regulation

Overview *(cont'd)*

- Level III Provisions (ESMA)
 - ESMA Q&A on the Benchmark Regulation (Version 17, 6.11.2020, ESMA70-145-114)
 - ESMA Guidelines on non-significant benchmarks under the Benchmarks Regulation (19.6.2019, ESMA70-145-1209)
- In Germany, BaFin's explanatory notes on the Benchmark Regulation

Types of Benchmarks

Critical* Benchmark (Art. 20)

- Reference for financial instruments with nominal amount of at least EUR 500 billion (quantitative criterion); or
- The benchmark is classified as critical by the national supervisory authority on the basis of qualitative criteria (e.g. relevance for the national financial economy); or
- Reference for financial instruments with a nominal amount between EUR 400 and 500 billion; no substitute benchmark available; significant damage to the financial system if the benchmark ceases to exist.

Significant Benchmark (Art. 24)

- Reference for financial instruments with a nominal amount of at least EUR 50 billion (quantitative criterion); or
- No substitute benchmark available; in the event that the benchmark ceases to be provided there would be a significant and adverse impact on market integrity, financial stability, consumers, the real economy.

Non-significant Benchmark (Art. 26)

- Means a benchmark that does not fulfil the conditions laid down in Articles 20(1) and 24(1)
- Useful for proprietary indices

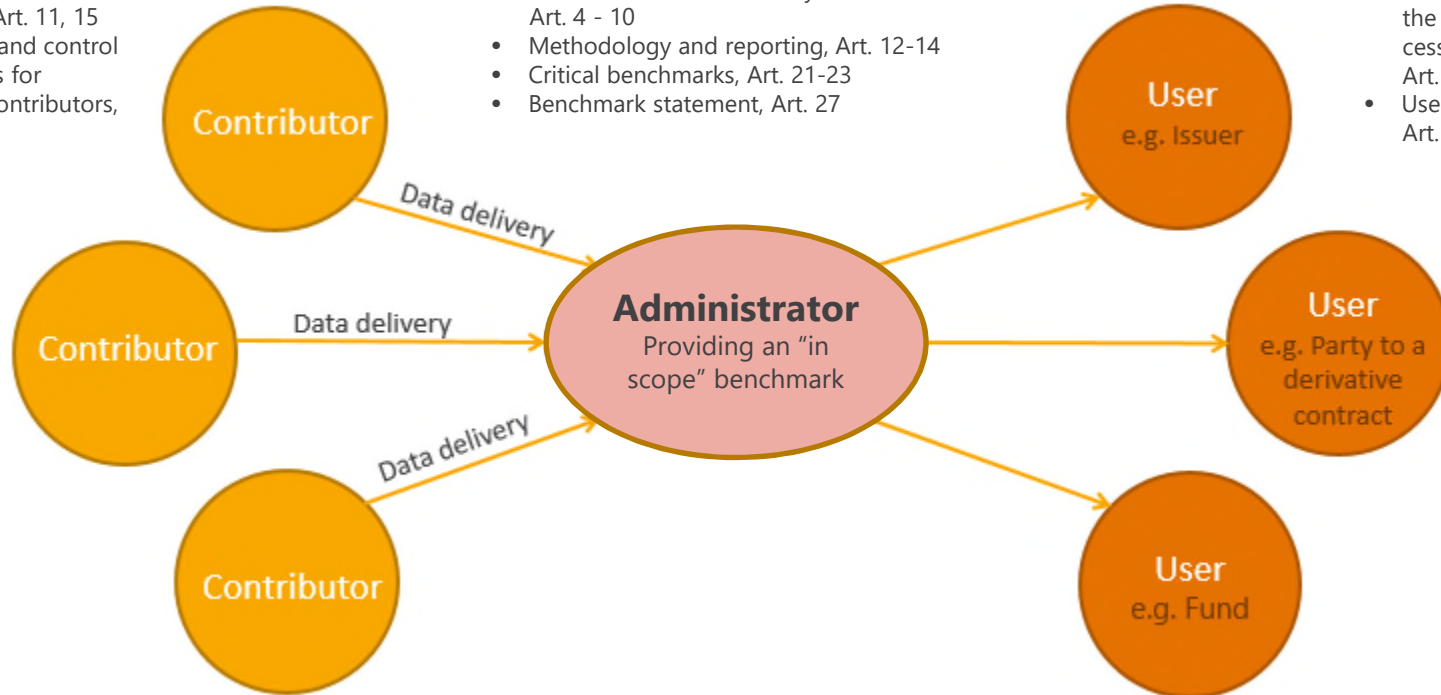
* Currently EURIBOR, STIBOR and WIBOR are classified as "critical" (Implementing Regulation (EU) 2019/482 of 22.3.2019)

Addressees of the Obligations under the Benchmark Regulation

- Adherence to the code of conduct, Art. 11, 15
- Governance and control requirements for supervised contributors, Art. 16

- Governance and control by administrators, Art. 4 - 10
- Methodology and reporting, Art. 12-14
- Critical benchmarks, Art. 21-23
- Benchmark statement, Art. 27

- Robust written plans for the case of benchmark cessation or any changes, Art. 28 II
- Use of benchmarks, Art. 29

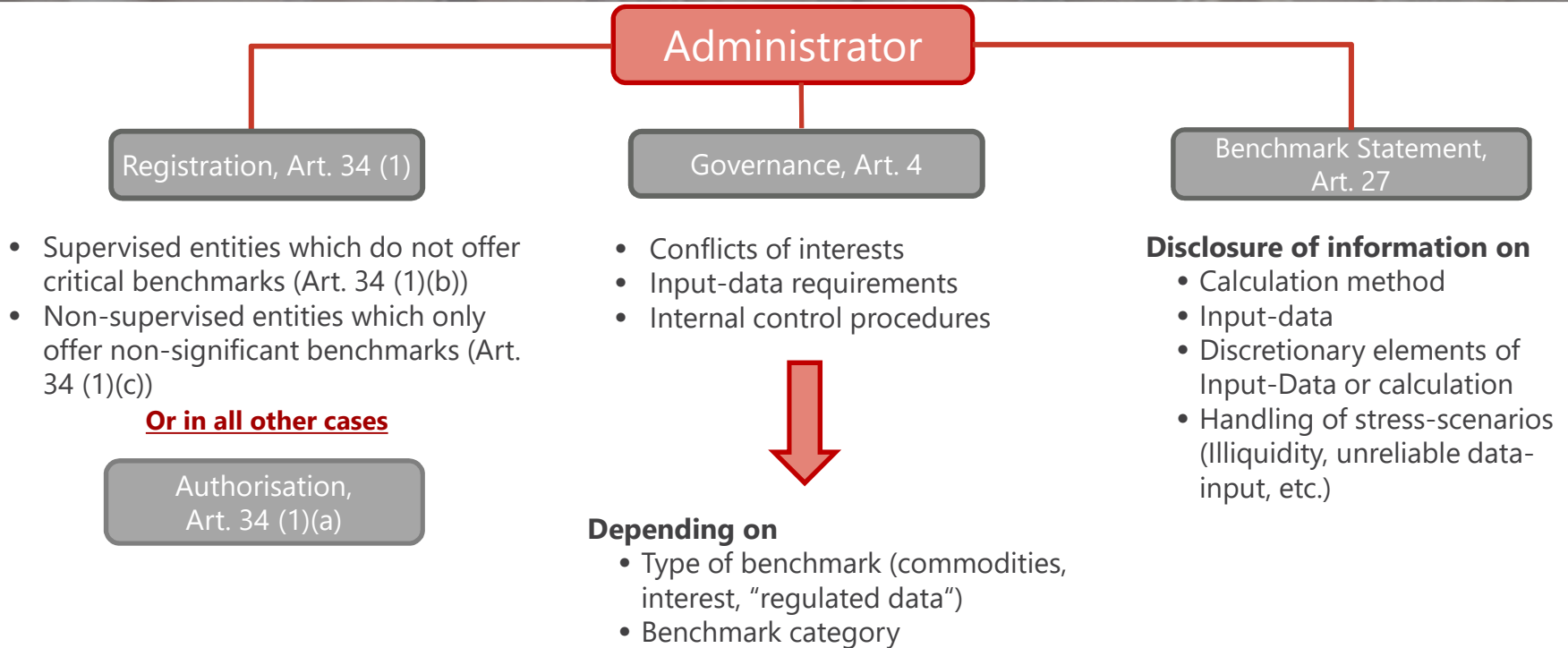


What is an “in scope” Benchmark?

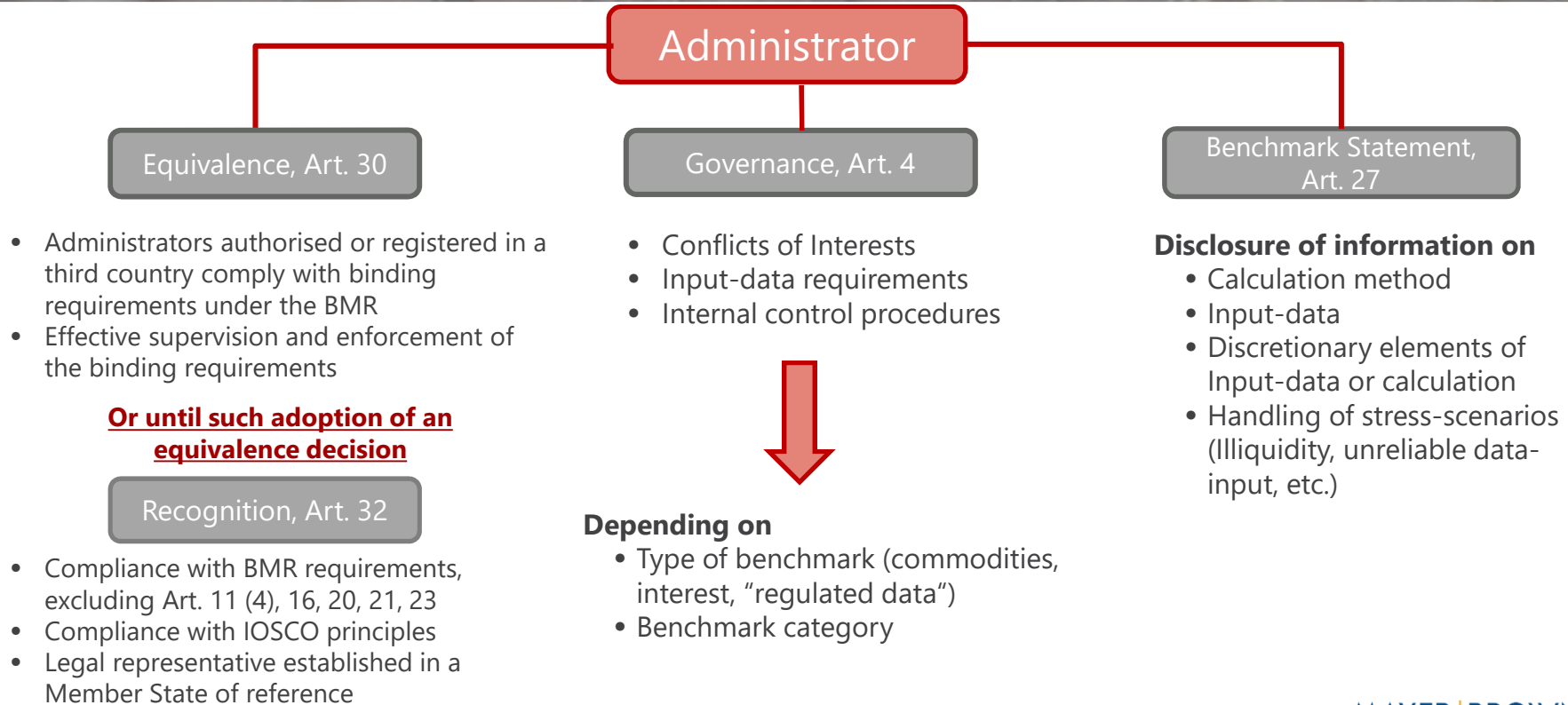
- **“In scope”** means any index that is:
 - Published or made available to the public
 - It needs to be accessible to a potentially indeterminate number of legal or natural persons
 - This means that even small proprietary indices could potentially come within the scope of the BMR
 - Regularly calculated using a formula or other method, or by an assessment on the basis of the value of one or more underlying assets or prices, actual or estimated interest rates, quotes and committed quotes or other values or surveys.

See Art. 3 para. 1 (1) BMR

Requirements for EU Administrators



Requirements for Third Country Administrators



The Use of Benchmarks from a Third Country Administrator

- As of 1 January 2024, benchmarks from third country administrators may only be used if one of the following cases is given:
 - An equivalence decision has been adopted (Art. 30 of the BMR);
 - The third country administrator has been recognised by a national supervisory authority (Art. 32 of the BMR); or
 - The respective benchmark has been endorsed by an EU administrator or a supervised entity (Art. 33 of the BMR).
- The transitional period for third country administrators was first extended from 20 January 2020 until 31 December 2021 by the amending Regulation (EU) 2019/2089, and most recently, until 31 December 2023 by the amending Regulation not yet published in the OJ of the EU (Art. 51 para. 5 of the BMR); a further extension is possible.

The Use of Benchmarks from a Third Country Administrator *(cont'd)*

- The provision of Art. 51 para. 5, regarding the transitional period for the use of third country administrator benchmarks, shall not apply to benchmarks provided by administrators who relocated from the Union to a third country during the transition period. The competent authority shall notify ESMA in accordance with Art. 35 of the BMR.
- As of 1 January 2022, the responsibility for the recognition of third country administrators will be transferred from the national supervisory authorities of the reference member states to ESMA in accordance with Art. 32 para. 1 of the BMR (Amendment Regulation [EU] 2019/2175, Art. 5 No. 10 e), No. 19: Amendment of Art. 32 para. 5, Art. 48n of the BMR).

The Use of Benchmarks from a Third Country Administrator – Pre and Post 2024

	Pre 2024	Post 2024	
Existing	Existing third country benchmarks are allowed to be used in the EU	Use in existing contracts	Use in new contracts
		Third country administrators are not required to be recognised	Third country administrators are required to be recognised
New	New third country benchmarks are allowed to be used in the EU	Third country administrators are required to be authorised to administer new third country benchmarks to be used in the EU	

Conflicts of Interest and the IOSCO and ESMA Guidance

- General requirements for conflicts of interest are set out in Art. 4 of the BMR
- Pursuant to Art. 5 of the BMR, ESMA decided on RTS, *see* Delegated Regulation (EU) 2018/1637 of 13 July 2018:
 - According to first recital of the Delegated Regulation (EU) 2018/1637, Art. 5 of Regulation (EU) 2016/1011 requires administrators of benchmarks to establish a permanent and effective oversight function.
 - According to Art. 3 of the Delegated Regulation (EU) 2018/1637, the oversight function shall also have procedures to the area of conflicts of interest.
- IOSCO Principles for Financial Benchmarks of July 2013 emphasize good governance in place to protect integrity of the Benchmark and to address conflicts of interest:
 - Section Governance, 3rd item (“Conflicts of Interest for Administrators”): Administrators should document, implement and enforce policies and procedures for the identification, disclosure, management, mitigation or avoid conflicts of interest. Administrators should review and update their policies and procedures as appropriate. Administrators should disclose any material conflicts of interest to their users and any relevant Regulatory Authority, if any.
- Additionally, ESMA-EBA Principles for Benchmark-Setting Processes in the EU of 6 June 2013 emphasize good governance, sound methodology and transparency, in order to limit the risks of conflicts of interest.

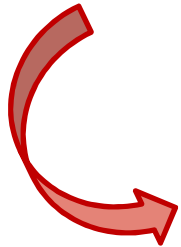
The Link between the Benchmark Regulation and the EU Prospectus Regulation

- Where the object of a prospectus to be published under Directive 2003/71/EC or Directive 2009/65/EC is transferable securities or other investment products that reference a benchmark, the requirements are set out in Art. 29 paragraph 2 of the BMR.
- Requirements according to Prospectus Regulation (EU) 2017/1129, applying from 21 July 2019 regarding:
 - Information concerning indices:
 - Comprehensive presentation and description of the used indices; those requirements do not apply where the administrator of the index is included in the public register maintained by ESMA under Article 36 of Regulation (EU) 2016/1011 (1), Delegated Regulation (EU) 2019/980 of 14 March 2019, Annex 17.
 - Essential information on conflicts of interest:
 - Description of any interest, including a conflicts of interest that is material to the issue/offer, Delegated Regulation (EU) 2019/980 of 14 March 2019, Annex 14.

Additional resources

Access the following to learn more:

- [REVERSEinquiries White Papers – Indices: The Good, the Bad and Knowing the Difference](#)



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