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CMCE response to the FCA consultation on extending the Senior Managers Regime to Benchmark Administrators

Moving from the APR to the SMR

Q1: Do you agree with our assessment that benchmark administrators are unlikely to meet the criteria for Enhanced firms under the regime?

CMCE agrees that Annex II benchmark administrators are unlikely to meet the criteria to apply the Enhanced regime.

Q2: Do you agree that all benchmark administrators should be subject to the Core regime under the SMR in the first instance? If not, please explain why.

CMCE disagrees with the application of the Core regime as the default regime for Annex II benchmark administrators and believes that Annex II benchmark administrators should be treated as Limited scope firms in the first instance.

Following our discussions during our call on 29 August 2019 and the roundtable on 20 January 2020, **CMCE would like to express again some concerns about the consequences that the application of the Core regime and the associated requirements may have on Annex II benchmark administrators, which have unique characteristics linked to their journalistic activities**. While we understand that FCA will conduct its assessment in line with the "substance over form" principle, CMCE believes that Annex II benchmark administrators will in most cases prove not to be appropriately characterised as Core firms and would expect them to meet the criteria for the Limited scope waiver proposed by FCA. It is fundamental under the BMR that the governance structures for Annex II firms are not – and should not be - subject to prescriptive requirements otherwise applicable to Title II benchmark administrators only.

As you may know, CMCE represents agriculture, energy, metals and other commodity market participants, trading venues and various media groups whose business includes the production of commodity price indices, established and/or operating in the EU, the European Economic Area, Switzerland and neighbouring countries. Our media groups operate large integrated editorial operations providing news, analysis and prices on commodity markets. Some of those prices are benchmarks for the purposes of the BMR; although, it should be stressed, the vast majority are not. **Despite reassurance to the contrary, we believe that the Core regime requirements could alter the carefully calibrated requirements of the BMR for Annex II benchmark administrators and their internal organisation**. While for benchmark administrators subject to Title II article 4 of BMR imposes governance and organisational requirements and

article 5 imposes a requirement for an oversight function, there is no equivalent requirement for commodity benchmark administrators under the Annex II regime. The requirement for independent external auditing under paragraph 18 of Annex II to the BMR provides the regulatory assurance which would otherwise have been addressed through governance and oversight requirements. **Annex II benchmark administrators are thus free under the BMR to organise their internal governance and allocate responsibilities internally in whatever way they consider appropriate, provided they meet the other requirements of Annex II**. **There is no prescriptive element to the regime in this regard.**

Further, during our discussions at the FCA roundtable on 20 January 2020, we were comforted that FCA has acknowledged that, in the case of Annex II benchmark administrators, the SMR and the Conduct Rules would only apply in respect of people who exercise control over the provision of a benchmark. We agree with that approach noting that, the BMR draws a critical distinction between "*provision of a benchmark*" as defined under article 3(5) of the BMR – which is not a regulated activity; and "*control over the provision of a benchmark*" which is how article 3(6) of the BMR defines the regulated activity of being an "*administrator*". This distinction under the BMR ensures there is no overspill of the BMR into mere journalistic activities. **Therefore, the SMR and the Conduct Rules should apply only to those senior managers and personnel to the extent their roles involve them in exercising control over the provision of a benchmark (and not to staff who are not involved in exercising control or to "control" staff in respect of any other functions they may conduct, including editorial functions in the provision a benchmark). We believe this should be the case for all benchmark administrators when they administer Annex II firms, whether or not they administer other benchmarks. Where SMR and the Conduct Rules apply, they should limit SMRs' responsibility to compliance with BMR in respect of "administration" activity within the BMR definition.**

Some of our members have since received a communication from FCA indicating that FCA would in fact seek to impose COCON not only on staff carrying the regulated activity of "*control over the provision of a benchmark",* but also on staff of carrying out "*related*" functions, even for Annex II firms. We have the gravest concern about this proposal and we do not understand FCA's reasons for it. It would drive a coach and horses through the distinction between "*control*" and "*provision of a benchmark*", and **would likely capture staff when carrying out journalistic activities effectively rendering their roles impossible to carry out in a regulated entity**. As you are aware from our many previous communications on this subject, there are **real conflicts between journalistic ethics and the requirements of COCON**.

We would kindly remind FCA that after the IOSCO PRA principles recognised the journalistic origins of all PRA price assessments, the BMR explicitly confirmed in Recital (16) and Article 2(2)(e) that the BMR does not apply to a journalist who does not have control over the provision of a benchmark. In addition, in paragraphs 3.22 and 3.23 of the Handbook Notice No. 56 dated June 2018, FCA gave assurance that the "*Handbook requirements* (will apply) *to a Price Reporting Agency (PRA) subject to Annex II of the BMR in a way that is consistent with the lighter requirements and standards that apply to that PRA under the BMR".*

We note, in addition, that FCA's approach would apply SMR and the Conduct Rules to staff involved in the provision of a benchmark, which is an unregulated activity, for any firm which administers a Title II benchmark, whether or not it also administers an Annex II benchmark. We believe this one-size fits all approach to "mixed firms" of this nature would materially disadvantage them against pure Annex II administrators and could therefore lead to unnecessary compliance overhead or drive unnecessary business restructuring. This is at odds with FCA's usual "substance over form" approach to supervision and could lead to the withdrawal of contributors to these Annex II benchmarks as they face – or at least perceive that they will face – more onerous requirements (something that would lead to less robust benchmarks, an outcome at odds with the FCA's own objectives). Similarly, journalists could conclude they would be subject to a more onerous regulatory regime if they joined an administrator doing both Annex II benchmarks and Title II benchmarks, something which would lead to recruitment and retention disadvantages.

Q3: Do you agree that our waiver-based approach allows enough flexibility for benchmark administrators with different governance models? If not, please explain why.

CMCE believes the Limited scope regime is better tailored for Annex II benchmark administrators. As indicated earlier, this regime would be more suitable to the existing governance and editorial oversight structures in place within our media organisations as Limited scope firms would have fewer SMFs to implement.

We welcome the fact that you made clear that the waiver would adjust the definition of SMF29 so that it covers the most senior person in a firm with day-to-day responsibility for benchmark administration activities. We also welcome the fact that other SMFs (SMF16 – Compliance Oversight and SMF17 – Money Laundering Reporting Officer) would not apply in the case of Limited scope benchmark administrators.

However, we would like to stress the importance of having a **clear and streamlined waiver-based process when applying for the Limited scope categorisation**. CMCE members include administrators, contributors and users of commodity benchmarks, as well as many firms who trade in pricing windows (or otherwise participate in price assessment processes) without contributing to a benchmark. Commodity benchmarks often relate to illiquid markets, where accurate price assessment can be challenging. The quality of benchmarks in such markets depends on ensuring that market participants are not discouraged from either contributing data or otherwise participating in the price assessment process. As pointed out during the roundtable on 20 January 2020, **we have some concerns concerning the procedural steps to follow to be authorised as Core firms while applying for the Limited scope waiver at the same time**. This will result in the need for firms to have preliminary meeting with FCA before submitting those applications. The reason for this is that firms will need to decide whether to authorise existing entities or to hive off the "control" functions into a separate entity for authorisation. Whether they do so – or are able to do so – will depend in large part on whether the Core or Limited scope regimes would apply to the authorised firm. There is, therefore, a "chicken and egg" question, depending on the FCA's approach to the waiver application, on which the basis of an authorisation application will depend. **Hence, we fear that the decision of whether to apply for the Limited scope regime and the absence of clear and predictable waiver process may trigger internal debates resulting in the loss of contributors, who might be discouraged from inputting in the price assessment process**. Indeed, market participants could be deterred from providing input to the price assessment process, impacting on the ability of administrators to produce robust, representative commodity benchmarks.

Q4: What are your views on our stated approach to assessing waiver applications? Are there factors we should exclude or other factors we should include?

As mentioned in our response to Question 3, FCA should provide sufficient transparency into the waiver process to enable firms to utilise it in a predictable way. While we would not advocate setting an inflexible set of criteria, we would urge FCA to give indicative guidance setting out some of the key relevant factors in assessing a firm's waiver application.

The FCA's operational objectives would need to be clearly listed and be proportionate to the specific objectives that the BMR aims to achieve by regulating benchmark administrators. At present, it is unclear what these objectives currently are, who is setting them, and who checks that they are complied with across all activities regulated by the FCA.

Separately, it is unclear what extensively means and how this can be measured.

Q5: Do you agree with our proposals for applying SMFs to Core and Limited Scope benchmark administrators?

Q6: Are there any Core SMFs or Prescribed Responsibilities that should not be applied to benchmark administrators?

Conduct rules

Q7: In line with our approach for other FCA regulated firms, do you agree that the Conduct Rules should be applied to all employees in benchmark administrators that undertake financial service activities?

We understand that FCA is using the term "financial service activities" to include any regulated activities under FSMA. We do not agree with the use of this term, as Annex II benchmark administrators can hardly be regarded as providers of "financial services" in the normal sense of the term. This may be perceived by contributors to Annex II benchmark administrators that we do provide financial benchmarks and that there could be requirements imposed on them. This would have a chilling effect on voluntary contribution.

We do agree that Annex II benchmark administrators would carry out "regulated activities" and, as noted in our response to Q1 above, we are firmly of the view that COCON should apply only to staff carrying out those activities and only when they do so. Any extension beyond this scope would bring journalists within COCON in respect of their journalistic activities. Not only would this be wrong in principle, but it would likely make the position of those journalists untenable, leading inevitably to staffing difficulties.

Q8: Do you agree that benchmark administrators should have 12 months to train other staff on Conduct Rules, in line with the extension of the regime for other FCA regulated firms?

CMCE would like to ask FCA to give 12 months for training from the date a firm becomes authorised by FCA. This could allow enough time to EU based firms to comply with the UK domestic regime if necessary.

Q9: Do you agree that the Conduct Rules should be tailored for firms that are subject to the Annex II regime under the BMR to reflect their specific treatment under the BMR?

CMCE supports the idea of promoting healthy cultures within financial services firms but would like to highlight the necessity of respecting the specific treatment of Annex II benchmark administrators under the BMR.

While CMCE members welcome the proposal made by the FCA to tailor the application of the Conduct Rules for benchmark administrators subject to the Annex II regime under the BMR, CMCE is gravely concerned by the proposal to apply the Conduct Rules to the activities of employees in carrying on the function not only of "*control over provision of a benchmark*" but also (as recently communicated by FCA to some of our members "*related activities*").

As we understand FCA's proposal in this respect, it would include employees carrying on "*related activities*" even if they are not involved in exercising "*control over the provision of a benchmark*". We cannot see how a person could be involved in the "*provision of a benchmark*" (an unregulated activity) without being carrying on "*related activities*" and, as such, this proposal would capture all the journalists involved in providing benchmarks. We believe this cannot be FCA's intention, as we note FCA had proposed to remove staff merely "providing benchmarks" from the scope of COCON for Annex II firms. CMCE is very concerned

as in the case of PRAs this would include journalistic and editorial staff. As indicated earlier, the BMR includes safeguards for journalists which the FCA's proposals, if carried forward, would contravene.

As noted, **individual Conduct Rules and Senior Manager Conduct Rules contain obligations which conflict with the responsibilities of editorial and journalistic staff**. FCA should also recognise that contributors and journalists may withdraw from supporting Annex II benchmarks if uncertainty and lack of clarity means they perceive a new regime could affect them.

Individual Conduct Rule 3 ("*you must be open and co-operative with the FCA, PRA and other regulators*") and **Senior Manager Conduct Rule 4** ("*you must disclose appropriately any information of which the FCA or PRA would reasonably expect notice*") both raise precisely the same conflict with the freedom of expression. It is vital that neither is applied to journalists in respect of journalistic activity. Chapter 2 of Title II of the BMR, which provides for the reporting of infringements by an administrator to an NCA, does not apply to Annex II administrators.

In addition, Annex II benchmark administrators adhere to "Editorial Codes of Conduct", which provide editorial staff with strict guidelines. They are designed to protect the independence, integrity, credibility, honesty and reliability of the media organisations and their work, and to ensure the reliability of – and confidence in – the services provided by them, including the integrity of the indices they provide. Where an "Editorial Code of Conduct" requires journalists to operate with impartiality, this is likely to conflict with **Individual Conduct Rule 4** ("*you must pay due regard to the interests of customers and treat them fairly*"). In fact, no editorial personnel should have "*customers*" or view their sources as customers, and they are required to act independently of the markets they report on. If an Annex II benchmark administrator has "*customers*" at all in respect of a regulated benchmark, those customers would typically include the trading venue to which the benchmark is licensed (and would not include market participants executing transaction referencing those benchmarks or market participants who contribute data).

We note – and appreciate – FCA's indication that the words "*due regard*" introduce an element of proportionality, but the *level* of proportionality to applied would ultimately remain unclear to administrators and the market. As a result, the rule would introduce a significant perception of a conflict of interest in the eyes of stakeholders, especially contributors and others who are not customers within the Handbook's meaning. In practice, such a duty to act in the interests of the trading venue (whose commercial interests are served by greater price volatility) would conflict with an Editorial Code requirement to be impartial or could otherwise impair the integrity of the benchmark. This is an example of a conflict that the current rigorous editorial standards, following best journalistic practice, explicitly eschews. Therefore, we would ask FCA to clarify the notion of "customer" by referring instead to definitions used in the BMR or reconsidering the application of this ICR entirely. The *integrity* of a benchmark should be a benchmark administrator's concern and that should not be confused or diluted by conflicting notions that it should act in the interests of a particular body of people to the detriment of that objective.

Individual Conduct Rule 5 ("*you must observe proper standards of market conduct*") is one of the most problematic rules and we are unsure how this rule is to be interpreted in the context of PRAs and editorial operations. The staff of the benchmark administrators are specifically prohibited from trading in any commodity for which their company produces price assessments, reports or other market intelligence. The same would apply to the company's own activities as an organisation, the companies do not participate in any market. As drafted and intended by FCA this principle is incompatible with the rules governing benchmarks administrators' editorial activities.

As indicated previously, we also have **concerns regarding administrators of Annex II benchmarks carrying on any other regulated activity, including administering other types of benchmarks**. Your current suggested exemption would only apply to administrators who do not do other financial services business other than Annex II benchmarks. As stated above, this seems contrary to the FCA's usual

approach of looking at substance over form, could lead to the withdrawal of contributors and be difficult to attract and retain relevant staff if they perceive journalistic freedoms count be curtailed.