CSA/ACVM Canadian Securities Administrators Autorités canadiennes en valeurs mobilières

CSA Notice and Request for Comment
Proposed Amendments to Multilateral Instrument 25-102 *Designated Benchmarks and Benchmark Administrators*
and
Changes to Companion Policy 25-102 *Designated Benchmarks and Benchmark Administrators*

April 29, 2021

Introduction

Today, the securities regulatory authorities (each an **Authority** and collectively the **Authorities** or **we**) of the Canadian Securities Administrators (the **CSA**) in British Columbia, Alberta, Saskatchewan, Ontario, Québec, New Brunswick and Nova Scotia (the **Participating Jurisdictions**) published Multilateral Instrument 25-102 *Designated Benchmarks and Benchmark Administrators* (**MI 25-102** or the **Instrument**) and Companion Policy 25-102 *Designated Benchmarks and Benchmark Administrators* (the **CP**). Subject to obtaining all necessary Ministerial approvals, the Instrument will come into force and the CP will come into effect in each of the Participating Jurisdictions on July 13, 2021.[1]

At the same time, as detailed in this Notice, the Participating Jurisdictions are also publishing for a 90-day comment period:

- proposed amendments to MI 25-102, and
- proposed changes to the CP.

Together, the proposed amendments to the Instrument and the proposed changes to the CP are referred to as the **Proposed Amendments**. The Proposed Amendments incorporate provisions for a securities regulatory regime for commodity benchmarks and their administrators.

The text of the Proposed Amendments is contained in Annex A and Annex C of this Notice and will also be available on websites of the Participating Jurisdictions, including:

www.lautorite.qc.ca
www.albertasecurities.com
www.bcsc.bc.ca
nssc.novascotia.ca
www.fcnb.ca
www.osc.ca
www.fcaa.gov.sk.ca

[1] For further details, see the CSA Notice of Multilateral Instrument 25-102 *Designated Benchmarks and Benchmark Administrators* and Companion Policy, dated April 29, 2021.

We are issuing this Notice to solicit comments on the Proposed Amendments. We welcome all comments on this publication and have also included specific questions in the "Request for Comments" section below.

Currently, MI 25-102 provides a comprehensive regime for the designation and regulation of specific benchmarks and their administrators, and the regulation of contributors and of certain users.[2] An overview of this regime was provided in the March 14, 2019 CSA Notice and Request for Comment on Proposed National Instrument 25-102 *Designated Benchmarks and Benchmark Administrators* and Companion Policy (the **March 14, 2019 CSA Notice**), and today, in the April 29, 2021 CSA Multilateral Notice accompanying the final published version of MI 25-102. The Proposed Amendments in this Notice are the amendments that were contemplated in the March 14, 2019 CSA Notice, under the heading "Expected Future Amendments for Commodity Benchmarks".

The Proposed Amendments intend to implement a comprehensive regime for:

- the designation and regulation of commodity benchmarks (**designated commodity benchmarks**), including specific requirements (or exemptions from requirements) for benchmarks dually designated as designated critical benchmarks and designated commodity benchmarks (**designated critical** and **designated commodity benchmarks** or **critical commodity benchmarks**), and for benchmarks dually designated as designated regulated-data benchmarks and designated commodity benchmarks (**designated regulated-data** and **designated commodity benchmarks** or **regulated-data commodity benchmarks**), and
- the designation and regulation of persons or companies that administer such benchmarks (**designated benchmark administrators** or **administrators**).

Currently, the Authorities do not intend to designate any administrators of commodity benchmarks. However, the Authorities may designate administrators and their associated commodity benchmarks in the future on public interest grounds, including where:

- a commodity benchmark is sufficiently important to commodity markets in Canada,

- a benchmark administrator applies for designation to allow its commodity benchmark to be referenced in financial instruments that are invested in by, or where a counterparty is, one or more European institutional investors pursuant to the EU BMR (defined below), and

- the Authorities become aware of activities of a benchmark administrator that raise concerns that align with the regulatory risks identified below in respect of such parties and conclude that the administrator and commodity benchmark in question should be designated.

[2] As explained in this "Introduction", the coming into force of MI 25-102 is still subject to Ministerial approvals in the Participating Jurisdictions.

Background

In 2011, the G20 Leaders requested the International Organization of Securities Commissions (**IOSCO**), in collaboration with other organizations, to prepare recommendations to improve the functioning and oversight of oil price reporting agencies (**PRAs**).[3] This request followed an earlier request by the G8 Finance Ministers in 2008, arising from concerns about oil price volatility, for IOSCO to produce recommendations intended to improve the efficiency and functioning of commodities markets.[4]

As outlined in the March 14, 2019 CSA Notice, in 2012, allegations of manipulation of the London inter-bank offered rate (**LIBOR**) led to the loss of market confidence in the credibility and integrity of not only LIBOR, but also in financial benchmarks in general. Although not on the scale of the LIBOR scandal, there have also been examples of manipulation or attempted manipulation of energy price indexes to benefit positions on futures exchanges.[5]

IOSCO PRA Principles

In October 2012, IOSCO published the *Principles for Oil Price Reporting Agencies* (the **IOSCO PRA Principles**),[6] setting out principles intended to enhance the reliability of oil price assessments that are referenced in derivative contracts subject to regulation by IOSCO members. This was followed by the publication in July 2013 of the *Principles for Financial Benchmarks* (together with the IOSCO PRA Principles, the **IOSCO Principles**). Although both sets of IOSCO Principles reflect similar concerns regarding the need for safeguards to ensure the integrity of benchmarks, the IOSCO PRA Principles were developed to focus on the specifics of the underlying physical oil markets.[7] Even though the IOSCO PRA Principles were developed in the context of PRAs in oil derivatives markets, IOSCO has encouraged the adoption of these principles more generally to any commodity derivatives contract that references a PRA-assessed price without regard to the nature of the underlying commodity.[8]

EU Benchmarks Regulation

Regulation in the European Union (**EU**) of commodity benchmarks is embedded within the EU's *Regulation on indices used as benchmarks in financial instruments and financial contracts or to*

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[3] PRAs are publishers and information providers who report prices transacted in physical and some derivatives markets and provide informed assessments of price levels at distinct points in time. See the IEA, IEF, OPEC and IOSCO October 2011 Report on *Oil Price Reporting Agencies*, specifically paragraph 1, available online at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD364.pdf.

[4] See the IOSCO March 2012 Consultation Report on the *Functioning and Oversight of Oil Price Reporting Agencies*, specifically Chapter 2, page 10, available online at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD375.pdf.

[5] For specific examples, see footnote 87 within IOSCO's September 2011 Final Report on the *Principles for the Regulation and Supervision of Commodity Derivatives Markets*, available online at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD358.pdf.

[6] Available online at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD391.pdf.

[7] See the IOSCO September 2014 Report on the *Implementation of the Principles for Oil Price Reporting Agencies*, specifically Chapter 1, pages 1 and 2, available online at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD448.pdf.

[8] See page 7, *supra* note 6.

measure the performance of investment funds (**EU BMR**).[9] A detailed overview of the EU BMR, including the regime applicable to third country administrators and specifics on the process of obtaining an EU equivalency decision, was provided in the March 14, 2019 CSA Notice.

The preamble of the EU BMR generally acknowledges that "[p]hysical commodity markets have unique characteristics which should be taken into account. Commodity benchmarks are widely used and can have sector-specific characteristics, so it [was] necessary to introduce specific provisions in [the EU BMR] for such benchmarks."[10] Annex II of the EU BMR sets out the provisions that are applicable to commodity benchmarks, and these provisions closely track the IOSCO PRA Principles.

Substance and Purpose

The Proposed Amendments were developed to establish an EU BMR-equivalent commodity benchmarks regulatory regime and to ensure the integrity of Canada's commodity and capital markets, thereby protecting Canadian investors and other Canadian market participants.

Although currently the Authorities have no intention of designating any commodity benchmarks or administrators of commodity benchmarks, as outlined earlier in this Notice, the Authorities may designate administrators and their associated commodity benchmarks in the future on public interest grounds, including in the case where an administrator applies for designation.

The proposed changes to the CP are meant to assist in the interpretation and application of the proposed amendments to MI 25-102.

EU Equivalency

It is desirable and important to have the EU recognize the proposed Canadian commodity benchmarks regime as equivalent since it would allow EU institutional market participants to continue to use any Canadian commodity benchmark designated under MI 25-102.

Although Canada-based administrators are able to directly apply for registration under the EU BMR, the Authorities are of the view that:

- Canadian securities regulators have a sovereign responsibility and are best positioned to directly regulate commodity benchmarks with a significant connection to Canada, including such commodity benchmarks' administrators, and

- it would be prudent to implement a Canadian regime by, or soon after, the EU equivalency deadline (i.e., January 1, 2024) in the event that, for example, a non-EU registered benchmark administrator of a Canadian commodity benchmark would like the benefit of a Canadian domestic regime that has been recognized as equivalent by the EU.

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[9] The EU BMR that came into force on June 30, 2016 is available online at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R1011&from=EN; the consolidated version of the EU BMR, as of 10/12/2019, is available online at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02016R1011-20191210&from=EN.

[10] See P(34) of the EU BMR that came into force on June 30, 2016, *supra* note 9.

Risk Reduction and Investor Protection

We believe that we should now amend MI 25-102 to establish and implement a regulatory regime for commodity benchmarks for the following reasons:

- commodity benchmarks may be subject to vulnerabilities arising from voluntary reporting of input data, relatively low liquidity in physically-settled contracts, and variation in methodologies both across benchmark administrators and within a single administrator (largely due to the complexities of the physical commodity markets),

- these vulnerabilities could create opportunities for manipulation of the input data (i.e., data on physically-settled trades) and for deliberate manipulation or attempted manipulation of a benchmark for the benefit of the contributor,

- methodologies generally use expert judgment, and without appropriate policies, procedures and controls in place, the price determination could be an unreliable indicator of the physical commodity market it is attempting to measure, and in turn make commodity derivatives contracts more susceptible to manipulation,

- many factors that have resulted in benchmark-related misconduct in other jurisdictions are also present in Canada,[11]

- a commodity benchmark that does not accurately and reliably represent the value of the underlying interest of the commodity benchmark for that part of the market the benchmark is intended to represent, either because of deliberate misconduct or because of inadequate controls to ensure the integrity of that benchmark, could adversely impact investors, market participants, and the reputation and confidence in, Canada's commodity and capital markets, and

- a commodity benchmark regime would clarify, strengthen and specify the legal basis upon which Canadian securities regulators may take enforcement and other regulatory action against benchmark administrators in the event of misconduct involving a commodity benchmark that harms (or threatens to harm) investors, market participants, and commodity and capital markets in general.

We are of the view that amending MI 25-102 to incorporate the commodity benchmark provisions would codify international best practices, as articulated under the IOSCO PRA Principles.

Summary of the Proposed Amendments to the Instrument

Designated Commodity Benchmarks and Benchmark Administrators

Under the securities legislation of each of the Participating Jurisdictions, a benchmark administrator can apply for designation as a designated benchmark administrator and request the

[11] For example, in 2008, the Commodity Futures Trading Commission obtained a $10 million civil monetary penalty in a consent order settling charges against Energy Transfer Partners, L.P., of Dallas, Texas and three subsidiaries. They were charged with attempting to manipulate natural gas prices at the Houston Ship Channel delivery hub. For further details, see footnote 46 in the IOSCO Final Report on PRAs, *supra* footnote 6.

designation of a commodity benchmark. Alternatively, the regulator can also apply for a benchmark administrator or commodity benchmark to be designated under securities legislation, or in Québec or Alberta the securities regulatory authority may designate a benchmark administrator or commodity benchmark on its own initiative. The proposed definition of a commodity benchmark is found in section 40.1 of the proposed amendments to the Instrument.

The CP explains that when applying for designation, a benchmark administrator should provide the same information as is set out in Form 25-102F1 and Form 25-102F2, with respect to the administrator and the benchmark, respectively. The CP also provides guidance on what factors a regulator or securities regulatory authority would consider in determining if a benchmark, including a commodity benchmark, should also be designated as a critical benchmark or a regulated-data benchmark.

When designating a commodity benchmark, a securities regulatory authority will issue a decision document designating the commodity benchmark as a designated commodity benchmark. If applicable, the decision document will also indicate if the designated commodity benchmark is dually designated as a designated critical benchmark or a designated regulated-data benchmark.

As explained below, a regulated-data benchmark that is also a commodity benchmark may be designated only as a regulated-data benchmark, or dually designated as a regulated-data commodity benchmark. Such benchmarks, whether they receive a single or dual designation, would not also be designated as critical benchmarks. This is in contrast to the possible dual designation of a financial benchmark as a designated regulated-data and designated critical benchmark.

In summary, the possible designations for a commodity benchmark are as follows:

	Designation			
Type of benchmark	**Designated commodity benchmark**	**Designated commodity and designated critical benchmark**	**Designated regulated-data benchmark**	**Designated regulated-data and designated commodity benchmark**
Commodity benchmark	X	X		X
Critical benchmark		X		
Regulated-data benchmark (type 1)[12]			X	

[12] Regulated-data benchmark that meets the definition of a commodity benchmark under section 40.1, but not the criteria under subsection 40.2(3).

Regulated-data benchmark (type 2)[13]				X

General Requirements for Administrators of Commodity Benchmarks

Both the IOSCO PRA Principles and the regulations under Annex II of the EU BMR were developed by considering the characteristics of physical commodity markets without focusing on the regulation of contributors of input data, largely because of the voluntary nature of market participants' contributions of input data and the concern that overregulation of potential contributors could discourage such participants from providing their data. The approach has been to create incentives for PRAs or benchmark administrators to institute processes designed to enhance the reliability of assessments that are indicators of the price or value of the physical commodity that underlies a derivatives contract.[14]

Designated benchmark administrators of commodity benchmarks have to comply with some requirements that are applicable to all administrators, and some, as provided under proposed Part 8.1 of MI 25-102, that are specific to administrators of commodity benchmarks. These requirements include:

- delivering audited annual financial statements and certain forms (e.g., Form 25-102F1 *Designated Benchmark Administrator Annual Form* and Form 25-102F2 *Designated Benchmark Annual Form*) to Canadian securities regulators (Part 2);

- maintaining a control framework to manage operational risk and to ensure that there are controls in place with respect to business continuity and disaster recovery plans, and contingency procedures in the event of a disruption to the provision of the designated commodity benchmark (section 40.4);

- maintaining appropriate controls and oversight over the process of the provision of a commodity benchmark (subsection 5(1)), including specifying the responsibilities of a compliance officer (section 6) and the requirements and responsibilities of benchmark individuals (section 40.11);

- maintaining an appropriate accountability and control framework to address conflicts of interest (section 40.13), complaints (section 12), reporting of contraventions (section 11) and outsourcing (section 13);

- applying policies, procedures and controls relating to input data (section 40.10), as well as complying with obligations relating to the benchmark methodology used by the administrator (sections 40.5, 40.7 and 40.8) and any changes to such methodology (section 17);

[13] Regulated-data benchmark that meets the definition of a commodity benchmark under section 40.1 and the criteria under subsection 40.2(3).
[14] See specifically page 8 of the October 2012 IOSCO paper, *supra* note 6.

- publishing information about the administration of its designated commodity benchmarks, including publishing:
    - key elements of the methodology and other required information about the methodology or the determination of a designated commodity benchmark (sections 40.5, 40.6 and 40.9),
    - the procedures relating to a significant change or cessation of a benchmark (sections 17, 20 and 22), and
    - a specified benchmark statement (section 19);
- keeping specified books, records and other documents for a period of 7 years (section 40.12); and
- engaging a public accountant to provide an assurance report on the administrator's compliance with certain key sections, including proposed sections of MI 25-102 and the methodology for the commodity benchmark and publishing a copy of the assurance report (section 40.14).

Additional Administrator Requirements for Critical Commodity Benchmarks

Where a commodity benchmark is also designated as a critical benchmark and the underlying commodity is gold, silver, platinum or palladium, then it is proposed that Part 8.1 not apply. Typically, such commodities function as stores of value, and their benchmarks, if critical, closely resemble financial, rather than commodity benchmarks. Thus, the requirements under Parts 1 through 8 would apply to such benchmarks, including the additional requirements under Part 8, Division 1, specifically sections 27 to 33 of MI 25-102.

If the underlying commodity is not gold, silver, platinum or palladium, then a dually-designated critical commodity benchmark would be subject to proposed Part 8.1, which provides for some exemptions from Part 8, Division 1 requirements. The additional requirements that would apply include:

- that the administrator provide specific notice to securities regulators and comply with other requirements if it intends to cease administering the critical commodity benchmark,
- that the administrator take reasonable steps to ensure that users have direct access to the critical commodity benchmark on a fair, reasonable, transparent and non-discriminatory basis, and
- that the administrator provide securities regulators with an assessment at least once in each 24-month period of the capability of the critical commodity benchmark to accurately and reliably represent that part of the market the critical commodity benchmark is intended to represent.

Exemptions for Regulated-Data Commodity Benchmarks

Under the Proposed Amendments, a commodity benchmark designated as a regulated-data benchmark is subject to the requirements under Parts 1 to 8, including the exemptions under section 40.

However, if a commodity benchmark is determined from input data arising from transactions of the commodity that is the underlying interest of the benchmark and the parties to those transactions, in the ordinary course of business, make or take physical delivery of the commodity, and that benchmark also meets the requirements of a regulated-data benchmark, then it is proposed that such a benchmark be dually designated as a designated commodity and a designated regulated-data benchmark. Such dually-designated benchmarks would be subject to Part 8.1 requirements, but exempted from certain requirements as provided by subsection 40.2(4). Fundamentally, this subset of regulated-data benchmarks, determined from transactions where, in the ordinary course of business, parties make or take physical delivery of the commodity, would maintain a closer link to the commodity markets, rather than the financial markets, and should be treated as commodity benchmarks. In contrast, regulated-data benchmarks based on financial transactions where counterparties hedge their exposure in underlying physical contracts or speculate on the movement of the price of a commodity, would more closely resemble financial benchmarks, and should be subject to the requirements under Parts 1 to 8.

To the extent possible, the proposed exemptions under subsection 40.2(4) would ensure that administrators of benchmarks dually designated as commodity and regulated-data benchmarks would receive comparable treatment under Part 8.1 as administrators of designated regulated-data benchmarks receive under Parts 1 to 8. Administrators of such dually designated benchmarks would be exempted from certain requirements, including requirements for:

- systems and controls for detecting manipulation or attempted manipulation,
- policies, procedures and controls relating to the contribution of input data and the accuracy, reliability and completeness of such data, and the publication of certain explanations for each determination of a benchmark, and
- the engagement of a public accountant to provide an assurance report on the administrator's compliance with certain key sections of MI 25-102, and the methodology for the commodity benchmark.

Summary of the Proposed Changes to the CP

The proposed changes to the CP, found under Annex C, provide interpretational guidance on elements of the proposed amendments to MI 25-102.

Anticipated Costs and Benefits of the Proposed Amendments to MI 25-102

The integrity and reliability of commodity benchmarks is important to the functioning of commodity derivatives markets. Currently, the Authorities do not intend to designate any administrators of commodity benchmarks, but as outlined earlier in this Notice, we may do so in the future based on public interest grounds, including in the case where an administrator applies

for designation or if we become aware of activities that raise risk or investor protection concerns. The proposed requirements under Part 8.1 of MI 25-102 are substantially similar to the requirements under Annex II of the EU BMR, which generally codify international best practices, as articulated under the IOSCO PRA Principles. Such regulation is meant to ensure that commodity benchmarks have adequate protections against potential manipulation and that the provision of these benchmarks is subject to appropriate systems and controls, with administrators having in place appropriate standards of corporate governance. Where appropriate, such as in the case of certain regulated-data benchmarks, we have tailored the requirements to the Canadian commodity markets.

The proposed regulation of commodity benchmarks should enhance the confidence of stakeholders in the Canadian commodity markets and minimize the potential costs that may be borne by the Canadian commodity and financial markets, including investors, in the event of the unreliability or manipulation of designated commodity benchmarks.

Overall, the Authorities are of the view that the regulatory costs of the Proposed Amendments are proportionate to the benefits that would be realized by impacted market participants and the broader Canadian commodity market.

Unpublished Materials

In developing the Proposed Amendments, we have not relied on any significant unpublished study, report or other written materials.

Local Matters

Where applicable, Annex F provides additional information required by the local securities legislation.

Request for Comments

We welcome your comments on the Proposed Amendments and also invite comments on the specific questions set out in Annex E of this Notice. Please submit your comments in writing on or before **July 28, 2021**. If you are not sending your comments by email, an electronic file containing the submissions should also be provided (**in Microsoft Word format**).

We cannot keep submissions confidential because securities legislation in certain provinces requires publication of the written comments received during the comment period. All comments received will be posted on the websites of each of the Alberta Securities Commission at www.albertasecurities.com, the Autorité des marchés financiers at www.lautorite.qc.ca and the Ontario Securities Commission at www.osc.ca. Therefore, you should not include personal information directly in comments to be published. It is important that you state on whose behalf you are making the submission.

Address your submission to the following CSA jurisdictions:

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Nova Scotia Securities Commission

Deliver your comments **only** to the addresses below. Your comments will be distributed to the other participating CSA jurisdictions.

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Contents of Annexes:

This Notice includes the following Annexes:

Annex A: Proposed amendments to Multilateral Instrument 25-102 *Designated Benchmarks and Benchmark Administrators*[15]

[15] The proposed amendments and the proposed changes, and blacklines provided, are with respect to the final versions of the Instrument and CP published by the Authorities today, on April 29, 2021. For further details, see the

Annex B: Blackline of Multilateral Instrument 25-102 *Designated Benchmarks and Benchmark Administrators* showing proposed amendments

Annex C: Proposed changes to Companion Policy 25-102 *Designated Benchmarks and Benchmark Administrators*

Annex D: Blackline of Companion Policy 25-102 *Designated Benchmarks and Benchmark Administrators* showing proposed changes

Annex E: Specific Questions of the Authorities Relating to the Proposed Amendments

Annex F: Local Matters (where applicable)

Questions

Please refer your questions to any of the following:

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CSA Notice of Multilateral Instrument 25-102 *Designated Benchmarks and Benchmark Administrators* and Companion Policy, dated April 29, 2021.