Investment in Derivatives Referencing Benchmarks

Questions / Answers

Please do not hesitate to send your questions to BusinessDevelopment@arendt.com

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Question 1: If an investment manager is trading on behalf of the client, who will be considered as the counterparty to derivative transaction for the purposes of Q&A 5.2(d)?

The key is to focus on the contractual nexus. If ultimately the entity that is bound by the contract is the client, then it would be the client that would be seen as the counterparty also from a regulatory perspective. Although the case may be that the terms of the transaction were negotiated by the investment manager, the investment manager was still acting as an agent for his client. However, if the investment manager itself would be the counterparty to the contract acting in its own capacity, then the investment manager will be treated as the counterparty to the trade also from a regulatory perspective.

Question 2: Would you agree that in the instance that a management company performs individual portfolio management (MiFID add-on service), and the discretionary portfolio management agreement ("DPMA") merely references an index in order to compare/determine the performance (without restricting the asset allocation), it should not be considered as "use of a benchmark"?

In this instance, the reference to an index in order to compare the performance will not be considered as the "use of a benchmark". This is the case for two reasons. Firstly, if the management company acts in the capacity as an individual portfolio manager, it would not be measuring a performance of an investment fund. Secondly, if it is in the context of the DPMA itself, there would not be a single financial instrument, the performance of which is being measured. Therefore, it would not fall into any of the other instances provided for by the definition of "use of a benchmark" under the Benchmark Regulation.

Question 3: What should an asset manager do if the index provider is not yet authorised and the benchmark is used by the fund manager as a benchmark with regards to the performance fee?

In this case, the asset manager must ensure that there is sufficient contingency planning in place. Once the initial transitional period will have passed (1 January 2020), the asset manager may not use anymore non-significant benchmarks or significant benchmarks in each case provided by an EU benchmark administrator. That being said, critical benchmarks provided by EU administrators may still be used until 1 January 2022. Moreover, asset managers will be able to continue using benchmarks provided by third country benchmark administrators without a specific long-stop date with new use of benchmarks provided by third country benchmark administrators being allowed also until 1 January 2022.

Question 4: When an Investment firm acts as an agent on behalf of a segregated managed account/investment fund and adheres to the ISDA protocol, should it adhere once as investment firm or on behalf of each client separately?

This has to be analysed on a case by case basis. Depending on the legal set-up of the fund, the investment firm may be signing as an agent on behalf of the relevant fund or managed account (certainly the case where the fund is a separate legal entity. It may not be the case if the managed account is effectively part of the balance sheet of the investment firm's group). In the case where the investment firm is signing on an agency basis, its own adherence could not cover that set-up and a separate adherence for each client would be necessary.