



St Bartholomew House, 92 Fleet Street  
London EC4Y 1DG  
Telephone: 020 7353 1688 Facsimile: 020 7353 9296  
Web: <http://www.spc.uk.com>  
e-mail: [john.mortimer@spc.uk.com](mailto:john.mortimer@spc.uk.com)

Email: [MARKT-BENCHMARKS-CONSULTATIONS@ec.europa.eu](mailto:MARKT-BENCHMARKS-CONSULTATIONS@ec.europa.eu)

Our Ref: JM/JB/4.16

November 15<sup>th</sup> 2012

Dear Sir or Madam,

## **COMMENTS BY SPC ON EUROPEAN COMMISSION CONSULTATION DOCUMENT ON THE REGULATION OF INDICES**

We welcome the opportunity to comment on the above consultation document.

### **INTRODUCTION TO SPC**

SPC is the representative body in the UK for a wide range of providers of advice and services to work-based pension schemes and to their sponsors. SPC's Members' profile is a key strength and includes accounting firms, solicitors, insurance companies, investment houses, investment performance measurers, consultants and actuaries, independent trustees and external pension administrators. SPC is the only body to focus on the whole range of pension related services across the private pensions sector, and through such a wide spread of providers of advice and services. We do not represent any particular type of provision or any one interest - body or group.

Many thousands of individuals and pension funds use the services of one or more of SPC's Members, including the overwhelming majority of the 500 largest UK pension funds. SPC's growing membership collectively employs some 15,000 people providing pension-related advice and services.

This consultation document has been considered by SPC's European and Investment Committees, which comprises representatives of actuaries and consultants, insurance companies, investment houses, investment performance measurers and pension lawyers.

### **GENERAL COMMENTS**

Our view is that, to be effective, any regulatory response, whether at EU level or at national level, to the recent alleged manipulation of LIBOR, EURIBOR and TIBOR should be appropriately focused and proportionate.

The consultation document appears to open up the possibility of regulation of virtually all aspects the preparation and presentation of indices, for whatever purpose. We acknowledge the need for a broad definition of "benchmark" in the context of insider dealing and market manipulation, but we believe that the extension of a fixed definition to a wider commercial context, where customers/users of financial products are not required to use benchmarks by regulation, could have unintended consequences. If there is no statutory or regulatory requirement to use a particular index in pricing a financial obligation, we see no need for regulatory intervention.

As the consultation document recognises, in most cases, the construction and operation of indices is bound to be an imperfect science, but in the institutional environment indices have nevertheless been developed, which meet the practical needs of market participants and whose limitations are understood by the participants, where appropriate with the benefit of professional advice.

It is essential to recognise the importance of ensuring that users of benchmarks are well informed on their advantages and limitations.

We suggest that it would be beneficial to concentrate any discussion on the construction and governance of indices on situations where there are demonstrable conflicts of interest arising from the party or parties, which effectively control an index, also having a financial interest in its value.

It is understandable that the Commission has already moved to amend the proposals for the market abuse Regulation and the criminal sanctions for market abuse Directive, to clarify that any manipulation of benchmarks is clearly and unequivocally illegal and can be subject to administrative or criminal sanctions. It seems clear, however, that, in the light of regulatory sanctions imposed earlier this year, arising from the attempted manipulation of LIBOR, such manipulation is already in the scope of financial services regulation.

The consultation document recognises well that the global nature of many benchmarks is such that any regulatory action at EU level alone runs the risk of being ineffective. If users of indices perceive regulation at national or EU level to be over-burdensome, index providers will move outside EU jurisdiction. Therefore, regulation at EU level, as well as being ineffective, could diminish expertise in the EU on index provision.

Taking all the factors referred to above together, this suggests to us that any regulatory action on benchmarks should be sharply focused and should concentrate on key factors underlying conflicts of interest, on the basis of principles, rather than detailed prescription. The Commission should not seek to create a framework, within which the construction and operation of all kinds of benchmarks, of whatever kind, is a regulated activity.

## **RESPONSES TO CONSULTATION QUESTIONS**

We set out in this section our response to certain consultation questions, where we consider that this will assist in supporting our general view set out above.

**Question 2: Which benchmarks does your organisation use? What to you use each of these benchmarks for? Has your organisation adopted any different benchmarks recently and if so why?**

SPC itself does not use benchmarks, but the relevance of benchmarks to its Members is mainly in benchmarking the performance of asset managers and also in the derivatives market.

We take the opportunity to comment here on the final bullet point on page 4 of the consultation document. Firstly, this seems to suggest that actuarial tables fall within the definition of an index. The two are very different and we would not view actuarial tables as indices. Secondly, there is no LPI Index as such. Limited Price Indexation is an application of a broader price index.

**Question 3: Have you recently launched a new benchmark or discontinued existing ones?**

No.

**Question 4: How many contracts are referenced to benchmarks in your sector? Which persons or entities use these contracts and for which purposes.**

In the business areas in which SPC Members operate, contracts referenced to benchmarks are often used in operating performance related fees for asset managers. A key point is that the asset manager is not in a position to manipulate the benchmark against which its performance is measured.

There are also many swap and derivative contracts, used for instance in hedging liabilities or in creating equity structured products.

The Retail Prices Index and the Consumer Prices Index appear to fall within the proposed definition of “benchmark”, and are widely used in the UK pensions sector.

**Question 7: What factors do you consider to be most important in choosing a reliable benchmark?**

In our view, the most important factors in choosing a reliable benchmark are transparency of the methodology underlying it, the ability to verify the data upon which the benchmark is founded and instability of the benchmark when used for performance measurement.

We agree that increasing the transparency of any input data and the calculation of the index – in particular where discretion is exercised – could have beneficial effects.

**Question 8: What kinds of data are used for the construction of the main indices used in your sector? Which benchmarks use actual data and which use a mixture of actual and estimated data?**

Indices used by SPC members often comprise actual data, such as the traded market prices of listed securities. Sometimes they use estimated data, for example if an interest swap uses LIBOR.

**Question 10: What do you consider are the advantages and disadvantages using a mixture of actual transaction data and other data in a tiered approach?**

The key advantage of using a mixture of actual transaction data and other data is that a benchmark can remain continuously available even if actual transactions have not occurred. Estimated data can be perfectly satisfactory, provided that there is transparency on how the estimate has been carried out.

It would often be incompatible with flexibility, which users of benchmarks, often require to limit their composition only to actual data.

We welcome the recognition in the consultation document that changing the base, scope or frequency of a benchmark fundamentally changes it and might mean that it no longer meets its intended purpose and might therefore no longer be useful.

**Question 12: What specific transparency and governance arrangements are necessary to ensure the integrity of benchmarks?**

The focus on transparency and governance arrangement should be on situations where conflicts of interest arise where the controller of the benchmark also has an interest in its value.

The key need is for the compilers of the benchmark to have the necessary technical skills and for a suitably knowledgeable person to validate the data used to compile the benchmark.

**Question 13: What are the advantages and disadvantages of improving governance and transparency requirements through regulation or self-regulation?**

The advantage of operating governance and transparency requirements through self-regulation is that it is more likely that they will be phrased in terms of principles, rather than detailed requirements. As the consultation document recognises, any regulatory action would need to be global and excessive detail would make it much less likely that global consensus could be achieved. The scope for arbitrage between different sets of detailed requirements would be increased.

**Question 14: What are the advantages and disadvantages of making contributing data or estimates to produce benchmarks a regulated activity? Please provide your arguments.**

In our view there are no advantages and the disadvantage would be that detailed regulation across all benchmarks would be a huge and often unnecessary undertaking.

The consultation document describes a wide variety of types of, and purposes for, benchmarks and detailed regulation would have to cater for each separately.

All that should be necessary is for a suitably knowledgeable person to approve data or estimates.

**Question 23: Do you consider that responsibility for making adjustments, if inadequate data is available, should rest with the contributor of the data, the index provider or the user of the index?**

Responsibility should generally lie with the provider of the index to verify data. Where approximations are necessary, these should be made with maximum transparency.

**Question 29: What are the advantages and disadvantages of making benchmarks a regulated activity?**

Our comments elsewhere in this response are largely addressed to this question.

**Question 30: Is it possible and desirable to restrict the use of benchmarks? If so, how, and what are the associated costs and benefits? Please provide estimates.**

In our view it is neither possible nor desirable to restrict the use of benchmarks within an institutional setting and to continue to have benchmarks which are useful to those who use them.

Institutional users of benchmarks understand that benchmarks can be used in very different ways, in comparison with the purpose for which they were originally developed.

**Question 31: Should specific benchmarks be used for particular activities? By whom? Please provide examples.**

In an institutional setting it is appropriate for users of benchmarks to decide which benchmarks should be used for which purpose.

**Question 33: Who should have the responsibility for ensuring that indices used as benchmarks are fit for purpose? The provider, the user (firms issuing contracts referenced to benchmarks), the trading venues or regulators?**

In an institutional context, we suggest that the responsibility should lie with the user to ensure that an index is fit for their specific purpose, with the backing of professional advice. The provider should ensure transparency of methodology and data.

**Question 34: Do you consider some or all indices to be public goods? Please state your reasons.**

There seems to be an implicit assumption that if an index is a public good only public bodies should be allowed to publish it. Although indices might be public goods in an academic sense, the benefit to users, who are properly informed about their usage and purpose, would be undermined by unnecessary centralisation and control. The private sector can innovate much more readily than government if a new index is required.

“Nationalising” indices would lead to increased costs for government and may even work against the interests of users, if the public bodies responsible for their production are less accountable to the user than a private provider might be.

**Question 38: What conflicts of interest will arise in the provision of indices by public bodies? What would be the best way of avoiding these conflicts of interest?**

The obvious area for conflicts of interest is where indices provided by public bodies are subject to the influence of public policy objectives of the government of the day.

As in any other context, the key is usually to recognise and manage the conflicts, rather than to try to eliminate them.

Yours sincerely

John Mortimer  
Secretary