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**FRENCH BANKING FEDERATION RESPONSE TO THE
EUROPEAN COMMISSION CONSULTATION DOCUMENT FOR THE
REGULATION OF THE PRODUCTION AND USE OF INDICES
SERVING AS BENCHMARKS IN FINANCIAL AND OTHER CONTRACTS**

The *Fédération Bancaire Française* (the French Banking Federation, hereinafter FBF) is the professional organisation that represents the interests of the banking sector in France. It comprises all of the credit establishments registered as banks and doing business in France, i.e. more than 450 commercial and cooperative banks. FBF member banks have 40,000 permanent branches in France, 400,000 employees and 60 million customers.

French banks welcome the initiatives undertaken by the European Commission and the opportunity to contribute to the analysis of the reforms needed to restore confidence in benchmarks, among which the EURIBOR is of particular importance. The FBF shares the view that upholding the integrity and credibility of these market benchmarks is important.

The Commission's public consultation is broad in scope and includes not only interest rate-based benchmarks, but also commodity-based and other benchmarks. The FBF's response focuses on the scope for EURIBOR reform, as the EURIBOR represents a key interest rate benchmark in the euro area.

The FBF believes that the Commission's current assessment of the need for benchmark reform represents an opportunity to consider which measures can be taken to increase the EURIBOR's reliability, representativeness and resilience, which would in turn increase the market's confidence in the benchmark.

KEY POINTS

- The FBF believes that bringing benchmark and indices within the EU regime for market abuse is a step forward in order to re-establish confidence in the indices setting process.
- As described in the consultation, there are a large number of indices which are constructed in many different ways. The FBF highlights that a one-size-fits-all approach in this area is not desirable.

- The FBF considers that, given the systemic importance of the EURIBOR, authorities could be involved in the supervision of the EURIBOR rate-setting process. The Federation believes that entities such as the ECB and the European Securities and Markets Authority (ESMA) are well placed to assume such a role, with limited conflicts of interest.
- The FBF highlights that an eventual substitution of existent money-market indices by new ones or the introduction of changes regarding the calculation method would certainly have important legal and economic implications for financial institutions. The FBF believes that existing money-market indices should continue in order to limit the impact on existing legal contracts and customer loans as well as on potential litigation.
- The FBF stresses that a too rigid regime or drastic changes could make it difficult to get an appropriate number of panel banks to contribute to the money-market indices' setting process.
- The FBF considers that the process of reforming the EURIBOR, and potentially, other interest rate benchmarks should be coordinated at a European and global level to ensure consistency and a "level playing field".

SUMMARY OF QUESTIONS

CHAPTER 1

Indices and Benchmarks: What they are, who produces them and for which purposes

1) Which benchmarks does your organization produce or contribute data to?

Treasury and cash management services are a core activity within the corporate and investment banking arms (CIB) of French banks, hence the latter's active contributions to the EUR EURIBOR panel of banks and, in one instance, to the USD EURIBOR panel of banks. The global presence of French banks also explains their active contributions to the USD LIBOR and GBP LIBOR panels as well as to the LIBOR panels (EUR, JPY, CHF, CAD) albeit to a lesser extent.

French banks also contribute to numerous other indices owned by private and public bodies alike.

2) Which benchmarks does your organization use? What do you use each of these benchmarks for? Has your organization adopted different benchmarks recently and if so why?

Like many other financial institutions, French banks use various benchmark indices to which they may or may not reference contracts with their counterparties.

3) How many contracts are referenced to benchmarks in your sector? Which persons or entities use these contracts? And for which purposes?

When it comes to French banks' money-market activities, treasury and cash management

contracts are mostly referenced to and form the basis of the EONIA and EURIBOR. These contracts are used by market trading teams, by ALM departments for balance-sheet hedging, and by retail banking divisions as a basic reference for certain loans.

- 4) How are benchmarks in your sector set? Are they based on real transactions, offered rates or quotes, tradable prices, panel submissions, samples? Please provide a description of the benchmark setting methodology.**

The EONIA index is based on real transactions and calculated by the ECB on a daily basis. It is produced even if no trades have occurred. EURIBOR rates are based on real transactions where possible and on the “expert opinions” of contributing banks which factor in market events and trends.

- 5) What factors do you consider to be the most important in choosing a reliable benchmark? Could you provide examples of benchmarks which incorporate these factors?**

A benchmark should be transparent, clearly-defined and not based on subjective opinion. It should be robust and representative of a sufficiently large and diverse panel of banks, and should be reliable and sustainable for users. Lastly, adequate historical data should be available.

The EURIBOR meets these requirements and is to date recognised as not having been the victim of any particular disruptions in its setting process which is reliable and consistent.

CHAPTER 2

- 6) 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?**

Benchmarks used by banks such as the EURIBOR or LIBOR are based on estimates, with each panel bank independently announcing the rates to which they are prepared to commit.

- 7) Do you consider that indices that do not use actual data have particular informational or other advantages over indices based on actual data?**

The FBF considers that the choice of alternative benchmarks should be market-led, with users choosing the best alternatives for their needs. The FBF also believes that market participants should undertake an in-depth analysis of their use of quote-based interest rate benchmarks, understand both their advantages and limitations, and decide whether alternative benchmarks are better suited to their needs. The options with regard to reforming the EURIBOR by replacing it with alternative benchmarks are currently not obvious.

- 8) What do you consider are the advantages and disadvantages of using a mixture of actual transaction data and other data in a tiered approach?**

Using a mixture of actual transaction data and other data is tantamount to using an estimate which is corroborated by each actual transaction available. This tiered approach would not appear to be the most appropriate solution for the EURIBOR, for example, as it would imply

a major change in its definition (real borrowing rate of each panel member rather than the best rate offered between prime banks). This type of change would not only mean a potential credibility risk (continuity of fixing), but also various legal risks with potential consequences that are difficult to measure.

It is nonetheless an approach that should be tested in order to assess its value.

9) What do you consider are the costs and benefits of using actual transactions data for benchmarks in your sector? Please provide examples and estimates.

Generally speaking, as regards the process of data collection, the FBF believes that there is no single suitable solution for all types of indices. In the case of indices related to liquid markets, data for their calculation could be collected directly from the market, rather than using estimated data. However, actual and timely data is not always available; an issue which could further complicate the calculation process.

The issue of data confidentiality should also be assessed if actual data is used.

When it comes to the money market, it seems clear that the formal disclosure of the EURIBOR is both the most effective and the most relevant solution. Calculated on the basis of what one “prime bank” is quoting to another, it ensures that borrowers (corporations, small and medium-sized enterprises and individual customers) are offered the lowest rates. They are protected from a potential deterioration in credit in the region in which they operate, regardless of whether it is one of the most volatile euro zone markets (Greece, Italy, Spain) or a country in which lending conditions are the most stable.

A change in the benchmark index could lead to a credibility risk (continuity of fixing), legal grey areas and a long and costly transition period. It could also be costly in financial terms for the real economy with higher borrowing costs for clients.

Furthermore, an index based solely on actual transactions could present an even greater credibility risk as data on transactions with maturities of 3 months or more is virtually non-existent, particularly during crisis periods. After that there is also the problem of the continuity of fixings.

10) What specific transparency and governance arrangements are necessary to ensure the integrity of benchmarks?

The FBF believes that it is important that the entity issuing a benchmark has procedures in place to identify and manage conflicts of interest that could arise while producing the benchmark.

In this respect, an external observer with adequate competences for the role could be invited to the index setting process in order to guarantee the independence of the body developing the index.

The Federation believes that the way indices are produced and calculated has to be transparent and this type of information should be made public. Furthermore, the FBF believes that indices should be independent from any type of political decision.

In the more specific case of the EURIBOR, the FBF is in favour of three changes that would make contributions more secure and, in doing so, reinforce the credibility of the index. Any effective solution to the risk of manipulation is first to be found by strengthening governance

and security mechanisms.

- **Strengthening of governance and security measures:** the European Banking Federation (EBF) carries out an internal audit of procedures in order to verify the robustness and, where applicable, improvements to be made to the articles of association, code of conduct and governance of the EURIBOR (Chinese walls, audit procedures, monitoring of the size of the panel, ex-post controls, review of sanctions).
- **Inclusion of a regulator/supervisory body:** French banks are in favour of the ECB which already calculates the EONIA and appears to be the most legitimate institution to ensure compliance with the different mechanisms used to set the index and restore market confidence. While the ECB has yet to confirm its desire to perform this role, the European Securities and Markets Authority (ESMA) has indicated that it would be prepared to take on this responsibility.
- **Increase in the number of panel banks:** it may be advisable to increase the number of contributing banks. Increasing the panel to include all banks required to maintain the ECB's mandatory reserves¹ for interbank operations, to which certain size criteria apply and which have integrated a regulator within their Supervisory Committee should limit room for manipulation.

The goal of a potential European governance framework must be to minimize the probability of misconduct through a combination of sanctions and highly robust processes that cannot be manipulated. Ideally, both the private and the public sector would help to make the reported rates robust by setting principles and designing the process.

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

The FBF believes regulation of contributing data can have its advantages and disadvantages. In addition, FBF would like to stress that not all benchmarks are produced with the same type of data. Indices that are based on real transactions data should not be subject to the same degree of regulation as in principle it is less likely that they will be subject to manipulation. The most appropriate solution will depend on the benchmark required and market concerned.

Where the money market is concerned, for example, it would appear that in the case of the EURIBOR, the current formal disclosure requirements are the most appropriate insofar as the panel is large and diversified. It is also more rational in economic terms and in the interests of the end customer.

12) Who in your sector submits data for inclusion in benchmarks? What are the current eligibility requirements for benchmarks' contributors?

It is the Euro treasurers who contribute to the Euro benchmark given their expert knowledge of the cash and derivatives markets. Since the first contributions were made, data has been recorded and sent to the organism in charge of collecting rates. The recording and definition of indices come under the "job description" of treasurers.

¹ A broad sample which would also include the various institutions which already contribute to the panel but are domiciled outside of the euro zone.

13) How should panels be chosen? Should safeguards be provided for the selection of panel members, and if so which safeguards?

Panels must include a majority of solid counterparties whose active role on their respective markets is recognised by the already accredited counterparties, and who clearly have an expert knowledge of the benchmark index. Greater diversity and a larger panel could mean greater objectivity in quotes, but could also mean the risk of a potential conflict of interest. An audit of the counterparties that wish to become part of the panel may be necessary.

Lastly, the panel must also represent all of the geographic regions for which it serves as a benchmark.

14) How should surveys of data used in benchmarks be performed? What safeguards are necessary to ensure the representativeness and integrity of data gathered in this way?

The majority of French banks now apply tighter internal procedures and consistency controls.

15) What are the advantages and disadvantages of large panels? Even in the case of large panels could one panel member influence the benchmark?

The larger and more diverse the panel, the more objective quotes are likely to be. This is particularly true in the case of the EURIBOR EURO panel.

The number of counterparties should be increased as much as possible. By broadening a panel, we automatically reduce the influence of contributors with untenable quotes.

16) What would be the main advantages and disadvantages to auditing of panels? Please provide examples.

There are no reasons not to perform an audit of eligible counterparties which would also be consistent with the desire for greater transparency in selection procedures.

17) Where indices rely on voluntary contributions, do you consider that there are factors which may discourage the making of these contributions and if so why?

There is some concern amongst establishments that certain banks may choose to withdraw from certain benchmark indices so as not to bear any responsibility, but this actually makes it even more important to increase the number of counterparties.

In case of an eventual substitution of existent money-market indices by new ones or the introduction of changes regarding the calculation method, the FBF stresses that it would certainly have important legal and economic implications for financial institutions, and could also lead to a downsize of the panel.

The Federation stresses that too rigid a regime or drastic changes could make it difficult to get an appropriate number of panel banks willing to contribute to the money-market indices' setting process.

18) What do you consider to be the advantages and disadvantages of mandatory reporting of data? Please provide examples.

If the EURIBOR is maintained for interbank operations, a possible solution would be to broaden its panel of banks in order to limit any inappropriate influence on its setting. The panel could be extended to all banks required to maintain the ECB's mandatory reserves, to which certain size criteria apply and which have integrated a regulator within their Supervisory Committee.

19) 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?

A formal process for setting quotes (suitable governance, panel and code of conduct; transparent procedures and methodology; adequate controls) should limit the introduction of incorrect data.

The responsibility for making adjustments if the data available is not sufficiently reliable should, however, rest primarily with the appropriate supervisory authority.

The FBF underlines that the inclusion of incorrect data should normally result in a rate that is significantly different from the average produced by the contributors and should therefore be eliminated. In its opinion, data submitted by an establishment should not be subsequently modified by any particular process.

20) What is the formal process that you use to audit the submissions and calculations?

French banks have a clearly-defined process which includes:

- 1) A set procedure for contributions;
- 2) Market data controls by a supervisory authority as well as by the bank's compliance department.

21) If there are any weaknesses identified in the audit, who are they reported to and how are they addressed? Is there a follow up process in place?

Since it was first created, EURIBOR quotes are subject to regular internal controls, but have yet to be audited by a national authority (ACP or AMF). This point could be addressed in order to improve the level of supervision.

In operational terms, establishments have implemented internal procedures to follow up fixings which are overseen by the compliance department. They have also introduced first- and sometimes second-level controls to identify any erratic changes in quotes.

22) How often are submissions audited, internally or externally, and by what means? Do you consider the current audit controls are sufficient? What additional validation procedures would you suggest?

Establishments are currently examining ways to reinforce procedures that are currently being defined according to a pre-set calendar.

23) What are the advantages and disadvantages of a validation procedure? Please provide examples.

A validation procedure ensures that establishments comply with predefined rules. It is a means of guaranteeing that setting processes are correctly applied in order to reinforce their quality and improve market confidence.

24) Who should have the responsibility for auditing contributed data, the index provider or an independent auditor or supervisor?

Contributed data should be audited at two levels: internally by an establishment's compliance department, and externally by the authority in charge of supervising the process.

25) What are the advantages and disadvantages of making benchmarks a regulated activity? Please provide your arguments.

Improving the level of regulation when setting benchmark indices would reinforce transparency and improve market confidence.

CHAPTER 3

The Purpose and Use of Benchmarks

26) 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.

Providing they are fit for purpose insofar as they are closely aligned with the market they represent, benchmark indices are useful in that they provide a point of reference for certain contracts. A benchmark should be the best possible measure of the economic reality its users face.

The multiplication of benchmark indices is not however advisable as it could potentially open the way for increased manipulation and a lack of transparency.

27) Should benchmarks developed for wholesale purposes be used in retail contracts such as mortgages? How should non-financial benchmarks used in financial contracts be controlled?

The EURIBOR index is used as a benchmark by a very wide range of counterparties, both financial and linked to retail banking.

Financial market observers have noted that the use of the EURIBOR as a benchmark index has, for example, enabled retail banks in Spain to benefit from refinancing conditions that are far more favourable than those offered by other banks and even by the Spanish government.

Contracts could, therefore, indicate that the EURIBOR is the best benchmark for bank loans but also has an inherent volatility.

A cap or floor for rates could be included in retail contracts.

Lastly, reference could also be made to a fixed rate as a risk-free alternative.

The use of a benchmark for certain types of markets or contracts could be subject to the approval of a higher authority, i.e. to controls by independent bodies.

A disclaimer should nevertheless be added which specifies the nature of the contract, the extent to which it is based on an expert opinion as well as whether it is based:

- On real transactions;
- On an expert opinion alone;
- On a mixture of actual and estimated data;
- Other criteria, etc.

28) 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 a first instance, all market operators must be able to assess whether or not a benchmark is fit for purpose.

This first assessment should be followed by a second control by the regulator.

Wide debate has also led to the conclusion that an external and undisputed authority should be involved in certifying the compliance of the benchmark.

CHAPTER 4

Provision of Benchmarks by Private or Public Bodies

29) Do you consider some or all indices to be public goods? Please state your reasons.

Debate as to the future of the LIBOR raises the issue of the conflicts of interest when private sector institutions contribute to quotes.

Public bodies, because they have better access to market data and are better placed to implement controls, could in theory easily replace contributions by certain private bodies in certain instances.

If we consider that indices are public goods as soon as they have a proven systemic value, the most appropriate solution in certain cases would be to associate public bodies with the models currently in place as part of a predefined supervisory process.

30) Which role do you think public institutions should play in governance and provision of benchmarks?

In the opinion of the FBF, public bodies have a role to play in accrediting the compliance departments of establishments in order to ensure their objectivity when publishing a benchmark.

31) What do you consider to be the advantages and disadvantages of the provision of indices by public bodies?

Where a private sector body has not been entirely successful in producing a benchmark, a public body that has no interaction with or interest in the benchmark concerned and is “irreproachable” should be involved in the process.

The involvement of a public body in the supervision of the calculation process of money-market indices, would positively contribute to the reinforcement of the credibility and integrity of these indices’ calculation process.

CHAPTER 5

Impact of Potential Regulation: Transition, Continuity and International Issues

32) What conflicts of interest would arise in the provision of indices by public bodies? What would be the best way of avoiding these conflicts of interest?

The FBF believes that an international framework for benchmarks that are used globally would be helpful in order to establish a worldwide “best practice” set of standards. The Federation is therefore supportive of IOSCO developing global principles.

In this respect, IOSCO has recently set up a Task Force which will develop policy guidance and principles for financial market benchmarks and aims to produce the final report towards the first quarter of 2013. In case EU regulators decide to present a stand-alone legislative proposal on indices and benchmarks, the FBF would encourage EU policy makers to consider IOSCO’s work in order to guarantee international consistency.

33) What are the likely transition challenges, costs and timelines for relevant benchmarks? Please provide examples.

The FBF believes that any EURIBOR reform should be managed in such a way as to achieve the desired results while minimising market disruptions. Any proposed changes aimed at making the EURIBOR more transaction and market-based need to consider the related legal and financial stability implications.

Added to the economic risk is the substantial litigation risk underlined in the WHEATLEY (FSA) report which is linked to the renegotiation of existing contracts where the legal consequences are difficult to predict.

34) How do you consider that the adoption of new benchmarks could be ensured? Is this best framed in terms of encouraging or mandating the use of particular benchmarks?

A change in benchmark index should be carried out under the supervision of the relevant authority. A study of the impact of the change will be necessary in order to assess the impact on the contracts referenced to it, as well as the legal consequences therein, notably if any of the counterparties were to file a class action.

35) What positive or negative impacts, if any, do you see on small and medium-sized enterprises of the possible regulation of indices, and how could any negative impacts be mitigated?

In the precise case of the EURIBOR, a change in the benchmark index would mostly likely create a credibility risk (continuity of fixing), legal grey areas and a long and costly transition period. It could also be costly in financial terms for the real economy with higher borrowing costs for clients.

36) Are there other impacts which should be considered? If so please specify the nature of these impacts and provide evidence.

A study by the FBF of the impact of changes to the EURIBOR points to the following consequences:

▪ **Separation of interbank and contract benchmarks:**

This option which would mean the creation of a new index would lead directly to a mechanical increase in the capital requirement of banks.

It raises more questions than it provides solutions: the multiplication of indices could open the way for increased manipulation and a lack of transparency. Moreover, creating this new index could lead to the introduction of capital market activities, thereby “mixing” instruments managed by treasury service providers and by fixed income operators.

▪ **Use of different underlying instruments: repo, OIS, CD**

Certificates of deposit or repos on certain asset classes could, for example, be listed on a benchmark for client operations. These instruments appear to be more representative than OIS which is highly volatile with a poorer match with the interests of the end customer.

They have the same disadvantages: they do not reflect the cost of liquidity and the interbank risk which is currently taken into account in the definition of the EURIBOR.

It would also mean “mixing” instruments managed by treasury service providers and by fixed income operators.

A change in the definition of the EURIBOR would not only mean a potential credibility risk (continuity of fixing), but also lead to major legal grey areas.

37) In which countries are benchmarks used in your sector produced? From which countries are data used for the production of benchmarks in your sector sourced? In which countries are benchmarks used in your sector used?

The global scope of the capital markets may prompt certain operators to favour one index over another in order to take advantage of different regulatory conditions.

It is important that the desired changes to the benchmarks result in customers being able to benefit from a “level playing field” that is entirely transparent.

38) Are there international benchmarks which could serve as substitutes for national benchmarks?

Euro benchmarks are international benchmarks.