ICAP

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By E-mail

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Dear Sirs

ICAP Response to the European Commission Consultation on the Regulation of Indices

ICAP welcomes the opportunity to submit comments to the European Commission's consultation on the regulation of indices. As an interdealer broker and provider of post-trade services, we believe our experience in facilitating money markets, arranging transactions in financial instruments that in many cases reference benchmarks and contributing data to indices such as the WMBA Sterling Overnight Index Average gives us a perspective that may be helpful in the context of the consultation.

The consultation is wide-ranging and we have therefore responded to those questions that are of most relevance to our business. Our response is set out at Annex A. As a general observation, however, we would note that benchmarks and indices can be developed from trade data and actionable data as well as indicative data built from market observable rates. Alternatively, a benchmark may be submissions-based, or a hybrid approach. However, for any of these methodologies a key success factor is the consistency with which the methodology is applied; the transparency of that methodology; the availability of the underlying data; and the governance and controls around the benchmark setting process.

ICAP appreciates having the opportunity to comment on the consultation paper and would be happy to discuss further.

Yours faithfully,

Duncan Wales

Group General Counsel

Annex A

Chapter 1

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

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

ICAP contributes data to a number of indices. These include several indices published by the Wholesale Markets Brokers' Association ("WMBA"), for example the Sterling Overnight Index Average ("SONIA"); Euro Overnight Index Average ("EURONIA"); and Repurchase Overnight Index Average ("RONIA"); as well as various Gas, Power and Carbon Indices published by the London Energy Brokers' Association ("LEBA").

ICAP, alongside Thomson Reuters, contributes to the collection of ISDAFIX, an interest rate swap valuation benchmark provided by ISDA, the trade association. ICAP collects trade data from market participants in USD, and Thomson Reuters collates the other five currencies that form part of the service.

ICAP also has a joint data product with Eurex (the derivatives exchange). The "Eurex ICAP Swap Spreads" acts as a real time benchmark for Euro yield spreads derived from ICAP brokered swap rates and Eurex government bond futures.

In addition, in 2008 and 2009, ISDA recognised 33 key ICAP displays and data sets as official price references in turn documenting specific products with ISDA. The ISDA Definitions booklet contains the standard conduct and provisions for swaps, interest rate, credit, and currency swap agreements and definitions for use in the creation and trading of swaps. ICAP's key derivative pages and chains on Thomson Reuters have been entered into the ISDA 2006 Definitions.

In the US, i-REPO^{SM} US Treasury GC Repo Index is a verifiable reference rate for valuation and benchmarking purposes for short-term repo, as an alternative to the short term unsecured Fed funds effective rate. i-REPO^{SM} US Treasury GC Repo Index is a volume weighted average of all overnight treasury GC repurchase agreement transactions executed at all three of ICAP's brokerage desks. i-REPO is posted twice daily at 10:00AM and 3:00PM.

(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?

As an interdealer broker and provider of post-trade services, ICAP does not participate as a principal in the deposit or derivatives markets and therefore does not make use of benchmarks other than for corporate treasury purposes.

(3) Have you recently launched a new benchmark or discontinued existing ones?

ICAP continues to invest in the development of indices. For example:

- ICAP UK Labour Market Indices, launched earlier this year, are designed to help forecast changes in employment levels, claimant figures, wage inflation and sectoral / geographic trends in hiring and trading conditions and sentiment in different sectors of the UK economy. They are aimed at investors, traders, economists, researchers and recruitment and human resources professionals.
- BrokerTec, ICAP's global electronic fixed income trading platform, and MTS, a leading European fixed income trading venue majority owned by London Stock Exchange Group, will shortly launch a new daily repo index series for Euro sovereign bond markets. The indices will be calculated using 1-day repo transactions and supported by actual trades rather than indicative quotes.
- ICAP US Treasury Indices: 15 frequent update (5 second) US Treasury Indices measuring the total return of portfolios of monthly rebalanced US Treasury bonds and notes, selected by remaining term to maturity.
- The Fed Board of Governor's H.15 time series is based on indicative quotes of 3-month Eurodollar deposit rates of prime banks provided by ICAP.

Previous indices include the New York Funding Rate ("NYFR"). Launched in 2008, the NYFR was intended to reflect the mid market rate of the broader wholesale market for unsecured bank funding on a spot basis, and cover a wider set of instruments and source of funds than LIBOR. After declining numbers of participants making submissions, leading to several days in July 2012 where no rate could be published, ICAP decided to cease polling participants and publishing NYFR in August 2012.

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

(5) To what extent are these benchmarks used to price financial instruments? Please provide a list of benchmarks which are used for pricing financial instruments and if possible estimates of the notional value of financial instruments referenced to them.

(6) 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.

Wholesale financial market participants use a wide range of benchmarks, all of which will have varying methodologies.

(7) 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?

The credibility of a benchmark depends on its integrity and its relevance to end users as a hedging tool for balance sheet exposure.

The relevance of a benchmark for end users is affected by its calculation methodology and data sources. The integrity of a benchmark depends on the methodology, the transparency around that

methodology and the consistency with which it is applied. The liquidity of the underlying market is also important (as low level of transactions can pose challenges to the quality of the data). Governance and controls around the setting of the benchmark, in particular in relation to a survey-based approach, are critical.

Ultimately, the choice of benchmark depends on how end-users weigh up the various factors relating to both relevance and integrity for a specific measure. The market acceptance of the specific benchmark depends on the methodology transparency, the ability to replicate the benchmark using the constituent or underlying data and, importantly, the independence of the underlying data.

Chapter 2

Calculation of Benchmarks: Governance and Transparency

(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?

Benchmarks and indices can be developed from actual transactions i.e. trade data; executable or actionable data; and indicative data that is built from market observable rates.

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

Certain indices if based solely on actual transaction data could pose challenges when markets are thin (as there would be few transactions against which to corroborate submissions; there is the potential for manipulation as only a small number of transactions at off-market rates could be sufficient to move the final rate fixing; and aged data would not be as representative). In addition, the indices risk over-representing a small number of market participants that happen to be active at time of fixing.

Whilst benchmarks and indices can be developed from trade data, actionable data, or indicative data built from market observable rates, a key success factor is the transparency of the methodology; the consistency with which the methodology is applied; and the availability of the underlying data.

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

We understand the "tiered approach" referred to here is a methodology that the Commission considers similar to that used by some price reporting agencies when setting commodity prices based on different levels of transaction data available i.e., a process whereby:

i) contributors of data are required to submit actual transaction data where this is available;
ii) if the data is not available, contributors provide a submission based on a model whose methodology has been pre-agreed and is transparent;
iii) if it is not possible to use a model, contributors may exercise judgement, providing the basis for this judgement is well-founded and documented; and

iv) if it is not possible to exercise judgement, contributors are entitled to refuse to make a submission.

In theory, such an approach appears sensible to the extent that it improves the relevance of the benchmark for end-users. But there are a number of risks. A tiered approach is less transparent and this may undermine its perceived integrity. The more complex the calculation methodology, the greater the risk of changes to this methodology over time, which may undermine its use for hedging of long-term exposures.

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

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

The precise arrangements will depend on the nature of the benchmark. As a general principle, those benchmarks derived from "real" data and that are solely transactions-based can largely be automated, providing there is transparency around the methodology and the underlying data is consistently available. Benchmarks derived from indicative data or through submissions / surveys need robust governance and control arrangements around the calculation and setting of the benchmark. There should also be clear and transparent criteria around participation; and where possible transaction data should be used to corroborate and audit submissions (although there would need to be some flexibility so that the methodology can be tailored to take account of market conditions and transaction size e.g. in a stressed environment, the number of transactions may decline and as such there will inevitably be greater reliance on inference and judgement).

(13) What are the advantages and disadvantages of imposing governance and transparency requirements through regulation or self-regulation?

In relation to transparency, ICAP considers that where individual submissions are made public on a daily basis there may be risks around credit signalling and, potentially, manipulation. Information on the cost of funds is market sensitive, especially at times of volatility or market stress, as this can be interpreted as an indicator of credit worthiness. More importantly there is also a feedback risk with potentially systemic implications. For example, the current LIBOR system effectively forces contributing banks to publicly pronounce on, and justify, their own perceived credit standing and ability to access unsecured funds from the market. In times of especially heightened risk aversion, this presents a feedback risk – i.e. a bank has difficulty accessing unsecured funds, the cost of funds increases and is disclosed publicly via the LIBOR submission, which in turn increases the difficulty in the bank's ability to access unsecured funds - that has the potential to escalate into a systemic failure of the banking system.

The alternative framework as established by the European Banking Federation for EURIBOR is somewhat different as banks are requested to submit a rate of where the best offered rate would be in each period, hence not specifically linking the submitted rates to their own credit worthiness.

For a submissions-based benchmark, confidentiality would minimise the risks of credit signalling. All submissions could remain confidential or as an alternative there could be publication of only those quotes that are included in the actual estimate, and deferred publication of those that are not.

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

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

A range of participants submit data, including banks /dealers, interdealer brokers, exchanges and other trading venues.

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

The composition of the panel will depend on the nature of the benchmark. Given the diversity of benchmarks and indices, a one-size-fits-all approach is unlikely to be appropriate.

(17) 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?

This will depend on the nature of the benchmark. The submission process should be as prescriptive in terms of the obligations of the participants.

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

Broad participation in panels could perhaps introduce more independence and potentially help mitigate any potential conflicts of interest that may arise (in the event the producer of the benchmark is also a contributor. However, in the case of a benchmark such as LIBOR, extending the panels to include more banks would mean including those that are less active in the unsecured interbank market with potentially more diverse credit ratings. This could undermine the quality of the index because in effect it would be a benchmark of a different measure, e.g. the AA/A curve rather than the AA curve.

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

This will depend on the nature of the index, the liquidity associated with the benchmark and the price transparency available within that market sector.

(20) 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?

Daily publication of individual submissions provides transparency but may also introduce risks around credit signalling and, potentially, manipulation. Publication of individual submissions could deter some banks from participating, in particular at times of extreme market stress.

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

(22) For entities contributing to benchmarks which are regulated by financial regulation, what would be the advantages and disadvantages of bringing their benchmark submissions under the scope of this framework?

We do not consider that those entities subject to financial regulation that contribute to benchmarks need to be subject to any additional regulatory framework. In our view, the regulator(s) should already have sufficient authority to regulate and supervise those entities that are making the submissions, through the requirement for the firm to put in place and operate within a proper framework of systems and controls.

(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?

This will depend on the nature of the index.

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

In the case of USD ISDAFIX collection[1], contributions are collected by ICAP and the rate calculated by Thomson Reuters (USD, USD Spread):

- ICAP collects spread information from contributors via a secure website that contributors log into every morning. Contributors are asked to indicate the USD swap spread as of 11:00 am, in accordance with the criteria set by ISDA as detailed above. At 10:58 am, ICAP will send an email reminder to each contributor reminding them to contribute. At 11:02 am, ICAP will indicate on the secure website a USD swap spread and USD swap rate to serve as a reference point for contributors. This reference point is generated from two sources of information:

    (1) Information contained on Reuters page 19901 at 11:00 am, which reflects the most recent swap spreads from completed trades and executable bids and offers in market size done/posted at ICAP.

[1] Source: http://www2.isda.org/asset-classes/interest-rates-derivatives/isdafix/

(2) Information reflecting executed trades and executable bids and offers at 11 a.m. for US Treasury securities from ICAP's BrokerTec US Treasury electronic trading platform.

By their nature, because both sources of information reflect completed transactions and/or at-risk trading interest, ICAP considers them to be a useful and meaningful reference point for where the market may be at that point in time.

- From 11:00 am to 11:15 am, contributors are able to submit their swap spread information and rate to the secure website. In terms of process, contributors may accept the reference swap spread and/or rate indicated on the website, or submit different values. During this time the ICAP swaps desk monitors dealer participation to ensure that the 10-bank minimum is met. As contributors submit spread and rate information, the values are sent to Thomson Reuters on a streaming basis.

- At 11:26 am, Thomson Reuters will calculate the USD ISDA FIX rate by eliminating a given number of the highest and lowest rates submitted, and then by calculating a simple average of the remaining rates. A rate will be posted as long as the Minimum Number of Contributions are received (Please see the pdfs attached under "What currencies and rates does ISDAFIX cover?" for the minimum number of contributions required to fix, and the given number of quotes that are topped and tailed.)

(25) 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?

Please see response to Q24.

(26) 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?

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

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

In the case of ISDAFIX, ISDA has the responsibility of governance and oversight.

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

Chapter 3

The Purpose and Use of Benchmarks

(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.

It is of course possible to restrict the use of benchmarks, but we do not believe this is desirable or, indeed, necessary. If benchmarks are found wanting, the market will migrate towards an alternative through choice, as happened in the 1980s when the US market moved from using US T-bills as the reference point to LIBOR, and also from Euro LIBOR to EURIBOR upon the creation of the Euro.

(31) Should specific benchmarks be used for particular activities? By whom? Please provide examples.

We do not believe it is necessary to mandate the use of specific benchmarks for particular activities.

(32) 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?

We do not believe it is necessary to "control" the use of non-financial benchmarks in financial contracts.

(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?

This depends on the nature of the index. In some cases, the regulator(s) may have a role to play, for example scrutinising and auditing submissions and having oversight of the setting process through representation on the relevant committee(s).

Chapter 4

Provision of Benchmarks by Private or Public Bodies

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

Certain indices, such as those published by national statistical authorities, can be considered public goods. In the UK, these would include the Consumer Prices Index and the Retail Prices Index produced by the Office for National Statistics.

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

This will depend on the nature of the index and the responsibilities assigned for collection, calculation, validation and distribution within the public institution or external parties.

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

We note that the Commission takes the view that indices produced by public sector entities are likely to be better placed to address conflicts of interest and may have the best access to the relevant underlying data. The Commission also observes that public bodies may be better placed to implement mandatory reporting if necessary.

On the basis that we assume the provision of execution, clearing and trade repository services will remain in the private sector, there will be practical issues as to (i) how a public body resources and manages collation, and (ii) designs, assures and develops indices. We agree that public bodies that are segregated from monetary policy decisions, interest rate setting, and government or agency borrowing should be independent and may be able to mitigate potential conflict of interests, but believe that this could also be achieved by independent commercial organisations. Indices are both the outcome of commercial activity and have a commercial purpose. One would hope and expect that indices, or classes of index would be developed, expanded and improved over time. Commercial demand and incentive may be the most efficient way to ensure challenge, consistency and evolution.

(37) Which indices, if any, would be best provided by public bodies?

We do not believe it would be possible for public bodies to assume responsibility for the large number of indices that are currently available. However there may be some benefit in agreeing (perhaps through IOSCO or FSB auspices) a set of common standards for the creation and oversight of benchmarks and indices.

Chapter 5

Impact of Potential Regulation: Transition, Continuity and International Issues

(38) 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 issue is more about the technical and commercial capabilities needed to deliver the Index provision function.

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

A transition to a new benchmark would need to be carefully managed. Existing securities contracts that reference benchmarks that are subsequently changed would need to be renegotiated and / or redrafted or allowed to run-off for a period of many years. If the benchmark is used globally, the transition would require international coordination and possibly some kind of phase in to avoid market dislocation and potential "jump risk".

(40) 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?

We do not consider it necessary to mandate the use of particular benchmark. The decision on the choice of benchmark instrument is a commercial matter and should be determined by real economy risk requirements, the financial markets and the participants to the contract.

(41) How can reforms of the regulation of benchmarks be most easily implemented?

(42) 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?

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

(44) 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?

ICAP is a global company operating in global markets. Our benchmarks draw from a wide range of data and are used globally.

(45) Are there non-EU benchmarks which could serve as substitutes? Are there non-EU benchmark providers which could produce similar benchmarks?

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