EUROPEAN COMMISSION
Directorate General Internal Market and Services

SUMMARY OF THE REPLIES TO THE CONSULTATION OF THE INTERNAL MARKET AND SERVICES DIRECTORATE GENERAL

ON

CONSULTATION ON A POSSIBLE FRAMEWORK FOR THE REGULATION OF THE PRODUCTION AND USE OF INDICES SERVING AS BENCHMARKS IN FINANCIAL AND OTHER CONTRACTS

JANUARY 2013

Commission européenne/Europese Commissie, 1049 Bruxelles/Brussel, BELGIQUE/BELGIË - Tel. +32 22991111

DG MARKT services held a public consultation between 15th September and 29th November 2012. Responses to the public consultation were received from:

- Member States financial authorities;
- Providers, contributors and users of benchmarks;
- Exchanges and clearers;
- Financial institutions and their associated bodies;
- Non-financial institutions in the energy and transport sectors; and,
- Individual citizens, academics and associations.

(Please see list of public contributors to the consultation at the end of this document).

Summary of the responses

Some 84 contributions were received, of which 75 were authorised for publication, including 8 from Member States (financial authorities and securities regulators), 9 from exchanges and clearers, 17 from index providers, calculators and publishers and associated bodies, 33 financial institutions and associated bodies (funds, banks, associations, investment funds, etc.), 3 from non-financial institutions and 14 from others (citizens, academics, associations, etc.). It should be noted that some institutions are both providers and users of benchmarks (e.g. exchanges) or contributors to and users of benchmarks (e.g. banks).

Contributions received from stakeholders varied in detail; the most developed comments were provided by public authorities and stakeholders involved in benchmark provision, submissions and use, as well as banks and exchanges.

Below are presented the overall reactions to the main issues in the provision and use of benchmarks raised in the public consultation document:

Global coordination: As benchmarks are globally produced and used, the process of reforming benchmarks should be coordinated at European and global level to ensure consistency and a level playing field. Thus, any EU initiative on benchmarks should be coordinated with the international consensus developed through the process that the Financial Stability Board is co-ordinating and which builds on the work by the IOSCO Board Level Task Force on financial market benchmarks.

Scope: Whilst an initiative on benchmarks is broadly supported for interbank lending benchmarks, there are mixed opinions about whether other types of benchmarks, such as commodity, equity and proprietary benchmarks, should be covered by an EU initiative on benchmarks. The main argument for this position is that for some of these benchmarks self-regulation is sufficient and that whilst all benchmarks share some characteristics, there are also many features which differentiate them and make them more or less susceptible to manipulation. Some of the differentiating features stated are the nature of the underlying data (ranging from actual transaction data to subjective estimates), the origin of underlying data (ranging from prices publicly available on exchanges to voluntary contributions in over-the-counter (OTC) markets), the replicability of the indices, the transparency of their methodologies and the degree of discretion applied in their calculation and the existence of inherent conflicts of interest in their provision. Furthermore, some benchmark providers, such as price reporting agencies (PRAs) state that their commodity price assessments are not financial but purely journalistic activities and thus they should not be covered by this initiative.

Role of regulation: There was a fair degree of consistency in the responses regarding the need to re-establish confidence in benchmarks which have shown to be susceptible to potential manipulation, mainly interbank lending benchmarks such as LIBOR and EURIBOR and other benchmarks sharing similar characteristics. However, there is not a clear consensus regarding the need for desirability of a regulatory framework for different categories of benchmarks. Whilst some respondents advocate for benchmarks becoming a regulated activity, others defend self-regulation by non-binding principles or industry codes of conduct. A two tier approach to regulation, with high level non-binding standards for all benchmarks and binding principles for specific benchmarks for which there is evidence of risks has also been suggested. Any regulation should be well calibrated in order to avoid burdensome overregulation and regulatory arbitrage.

Methodology: There is general agreement on the need for robust, fully transparent and understandable methodologies on benchmark production which allow users to replicate these benchmarks to the highest degree possible, allowing them to be used to verify the integrity of benchmarks and better assess whether their methodologies are fit for their needs. There is also overall consensus on the preference for the use of thorough methodologies over discretion and the preference for using underlying actual transaction data or firm bids and offers over subjective estimates or assessments. However, some contributors point out that for highly OTC, opaque, volatile or illiquid markets where few transactions take place, the use of estimates or assessments may be necessary and it may provide a better representation of the underlying market reality than insufficient or unrepresentative transaction data. In these cases, some respondents highlight the advantages of hybrid methodologies using both actual transaction data and estimates and ex-post verification of underlying data and the appropriate use of discretion.

Conflicts of interest/Potential for manipulation: There is broad consistency among respondents regarding the fact that providers of and contributors to benchmarks need to have adequate processes for identifying, avoiding and, if this is not possible, managing conflict of interest. The consultation responses link conflict of interest to the inappropriate use of discretion or the ability and the financial incentive to manipulate the benchmark value. Some responses mention specific references to inherent conflicts of interest in the provision of benchmarks in which the contributors or providers are also users of indices or interested parties. For example, for interbank lending rates (e.g. LIBOR and EURIBOR) and strategy/proprietary indices used and sometimes produced by fund managers who have direct interest in the performance of these funds. Some of the solutions to conflicts of interest issues suggested by respondents are reforms to governance, controls and compliance and the combination of competition, and transparency with tailored regulatory backstops when appropriate.

Panels and mandatory reporting: There is a broad consensus on the fact that panels must be representative and proportionate to the market they represent. However, some respondents point out that panels are in general prone to manipulation and information is better sourced from regulated markets and public/transparent sources whenever possible. Responses also highlight that the selection of panel, index contributors, or constituents should be based on clear, objective, and robust criteria and governed by relevant independent bodies and that panel members should be sufficiently numerous, diverse and sufficiently active in the underlying markets. Regarding potential mandatory participation, whilst some responses support it due to the advantages of large panels, these benefits could be undermined if panels become unrepresentative due to the inclusion on inactive or unrepresentative participants. Finally, some responses state that data submissions should be made only by entities regulated for this purpose and stress the possible advantages of requirements for transparency in panel reporting where current levels of transparency are inadequate. Some responses raise other potential transition issues which involve a potential decrease in market transparency if voluntary contributors are discouraged to contribute to benchmarks by new regulatory requirements.

Transparency: Most responses advocate for the highest level of transparency possible on governance, processes and methodologies at both provider and submitter level, as an effective way for users to monitor and encourage the robustness of benchmarks. However, it is highlighted in some of the responses that a high level of transparency on contributions in some particular markets, for example commodities, may discourage voluntary submissions. Furthermore, some respondents recommend delayed transparency for some indices in order to avoid potential credit or market signalling issues. Transparency on what benchmarks measure and their most relevant characteristics is recommended in most consultation responses as necessary for allowing users to make the right assessments on whether benchmarks are fit for purpose.

Governance and supervision: There is a broad consensus among the consultation responses regarding the need for high governance and transparency standards for benchmarks. Most responses request the highest level of transparency possible on governance, processes and methodologies at both provider and submitter level, as an effective way for users to monitor and encourage benchmark robustness

Accountability: audits & controls. There is general agreement on the need for more thorough audits and controls as they are key to ensuring the integrity of benchmarks, but at contributor and provider level. Independent external audits of contributions, calculation and benchmark production procedures have been highlighted by several responses as one of the main improvements required in this area.

Use: Many respondents argue that the choice of which benchmark to use should be left to the market and it should not be regulated. However, some respondents consider there is a need to regulate the use of benchmarks which affect retail investors or consumers and ensure financial controls are referred to robust and reliable benchmarks which comply with minimum standards in their provision.

Licensing: Many responses, mainly from users of benchmarks and public authorities, support the reforms for non-restrictive licensing of benchmarks in the Markets in Financial Instruments Directive (MIFID) based on reasonable commercial terms on a non-discriminatory open access basis, whilst other responses, mainly from benchmark providers, are against these reforms.

Public versus private provision: Although some contributors, mostly public authorities and consumer organizations, argue that benchmarks share some characteristics of public goods, others, particularly benchmarks providers, defend the private nature of benchmarks and point out the intellectual property rights associated to them. Most respondents agree that benchmark’s provision should be private as competition among different providers is one of the main incentives to enhance benchmarks’ robustness and integrity and ensure they keep up to the date with market developments. However, many responses agree in the fact that private provision of benchmarks should be subjected to the supervision of public authorities under a public regulatory framework.

Transition issues: Most responses agree on the need to take into consideration potentially important transition and legacy issues, especially if any initiative would require methodologies for the calculation of benchmarks or their definitions to be radically modified. This could trigger significant legal, economic and continuity issues.

Some responses also express that significant regulatory changes in this area could face real logistical, legal and other hurdles and that the potential impact of introducing a regulatory framework for benchmarks should be carefully assessed. Some respondents believe that the transition to substitute benchmarks should be authorized, encouraged but not imposed by the regulator. Finally, it is highlighted that there should be sufficient time for transition and it should be carefully managed and phased-in.

List of public contributors to the consultation (not including confidential responses)

Financial authorities – Public 6 - Total 8

BAFIN

Bank of Latvia

ECB Eurosystem

ESRB (European Systemic Risk Board)

French Treasury

HM Treasury UK

Index providers, calculators and publishers and their associated bodies – Total 17

Argus

Bloomberg LP

Danish Bankers Association

EURIBOR-EBF

ICI Global

ICIS

Index Industry Association

IPD (Investment Property Databank)

Markit

MSCI

Platts

Rate Validation Services

RIMES

S&P Dow Jones Indices

STOXX

Thompson Reuters

WMBA (Wholesale Market Brokers Association)

Exchanges and clearers – Public 8 – Total 9

BATS Chi-X

CME Group

Deutsche Börse Group

FESE

London Stock Exchange

NASDAQ OMX

NYSE Euronext

The Baltic Exchage

Financial institutions and associated bodies - Public 30 - Total 33

ABI (Associazione Bancaria Italiana)

AFG (Assoc. Française de la Gestion Financière)

AFME (Assoc. for Finantial Markets in Europe)

AIMA (Alternative Investment Management Assoc.)

AMUNDI Asset Management

ASSIOM FOREX (Financial Markets Association -Italy)

ASSOSIM (Italian Assoc. of Financial Intermediaries)

Barclays

BlackRock

BVI (German Investment Fund and Asset Mgt. Assoc.)

Caixabank

EFET (European Federation of Energy Traders)

EBF (European Banking Federation)

EUSIPA (European Structured Investment Products Assoc.)

French Banking Federation

GFMA (Global Financial Markets Assoc.)

ICAP

ICMA (Intl. Capital Market Assoc.)

IMA (Investment Management Assoc.)

ING

INTESA SanPaolo

ISDA (Int. Swaps and Derivatives Assoc.)

Kames Capital

Pfandbrief

Russell Investments

State Street

UBS AG

Unicredit

Vanguard

VOEB, Bundesverband Öffentlicher Banken (Fed. Assoc. of Public Banks in Germany)

Non-financial institutions – Total 3

Deutsche Lufthansa

EnBW (Energie Baden-Württemberg AG)

EON

Other – Public 11 – Total 14

BDEW (DE Federal Association of Energy & Water)

BEUC (European Consumers Organization)

CFA Institute

EDHEC Risk Institute

EuroFinuse (European Federation of Fin Serv Users)

Finance Watch

Financial Services User Group

Groupe Consultatif Acutariel Europeen

IATA

Lucidine Conseil

Society of Pension Consultants