



Benchmarks manipulation: EC consultation paper and other issues. November 2012.

The European Commission has published, on the 5th September 2012 (after the LIBOR manipulation case) a consultation report requesting stakeholders to comment on the possible framework for the regulation of production and use of indices serving as benchmarks in financial and other contracts. The integrity of benchmarks is critical to the pricing of many financial instruments and, consequently, lack of accuracy and integrity may cause significant losses to consumers and distort the real economy.

An index is a statistical measure, typically of a price or quantity, calculated from a representative set of underlying data. An index may then be used as a reference price or benchmark for a financial or other contract. The EC defines benchmarks, in the amendments of the Market Abuse Regulation proposal, as any commercial index or published figure calculated by the application of a formula to the value of one or more underlying assets or prices, including estimated prices, interest rates or other values, or surveys by reference to which the amount payable under a financial instrument is determined.

The methodology of a benchmark specifies who contributes to the data, how they are collected and how the index is calculated. The underlying data can be actual prices or transaction values and the indexes are objective and verifiable whereas, if the underlying data are historical or estimated data, they are considered as subjective estimates. In this last instance, the governance of the contributor of the data requires that the discretion exercised does not impact on the accuracy and integrity of the index and that a suitable framework mitigates the conflicts of interest that could arise if such entity had any kind of financial interest or other type of interest in the use of a concrete benchmark. Also, the calculation of an index, although is, normally, a relatively straightforward mathematical average of the underlying data, it requires in other cases that the index producer needs to make some judgements or exercise some discretion within a transparency framework that should describe potential conflicts of interest.

The benchmarks wide-spread use makes difficult the control by its producer of misalignments between a benchmark and its use; many benchmarks providers license third parties to use their benchmarks. However, in practice, it may be difficult to ensure that no unauthorised contracts are referenced to a benchmark. In this situation, one option would be to place responsibility on investment firms or trading venues for the suitable use of the benchmarks.

The recent allegations concerning the manipulation of benchmarks have emphasized the public interest in ensuring their integrity and accuracy -taking into account the network effects- and, these allegations, have also highlighted that some benchmarks have many of the characteristic of public goods. At present, even though a variety of private entities produce indexes, public institutions are better placed to address conflicts of interest. These public Institutions have the best access to the relevant underlying data and are better placed to implement mandatory reporting if necessary. Considerations should be given to whether and what important indexes should be provided by public bodies or whether public bodies should closely supervise their calculation, provision and governance.

As a complementary measure to the possible regulation of the production and use of indexes serving as

benchmarks, the EC has already moved to amend the proposals for the Market Abuse Regulation and the Criminal Sanctions for Market Abuse Directive. This action aims to clarify that any manipulation of benchmarks is clearly and unequivocally illegal and can be subject to administrative or criminal sanctions.

The amended proposal for a Market Abuse Regulation contains the administrative liability defining as market abuse the transmission of false or misleading information, providing false or misleading inputs, or any other action which manipulates the calculation of a benchmark, including the benchmark's methodology (this last added by the new Recital 20 Bis), without need to prove the effective impact of the index manipulation in the financial instrument prices referred or connected to it.

The amended proposal for a Directive on criminal sanctions for insider dealing and market manipulation establishes the criminal liability in case of transmitting false or misleading information, providing false or misleading inputs, or any other equivalent activity which intentionally manipulates the calculation of a benchmark.

A potential national regulation could raise a number of issues caused again by the global and generalised use of the benchmarks in the different jurisdictions and, accordingly, it would be desirable to ensure a consistent and coordinated approach at the international level. In this sense, measures are already being discussed by international organisations bodies such as IOSCO and the FSB. IOSCO, for example, in light of the significant issues raised by investigations into attempted manipulation of benchmarks, has constituted a Board Level Task Force on Financial Market Benchmarks with the aim of developing global policy guidance and principles for benchmarks. ESMA has also created a Task Force to study issues raised by benchmarks uses at European level.

Finally, Martin Wheatley (Managing Director Financial Supervisory Authority (FSA) and CEO designate Financial Conduct Authority (FCA)) has recently published a report that concludes that the evidence backs a strong case for reforming LIBOR and that the use of benchmarks must be regulated including mechanism to punish the manipulation offences and whose conclusions have been totally accepted by the british financial authorities.

If you want to read the EC consultation paper, please, do click on: http://ec.europa.eu/internal_market/consultations/docs/2012/benchmarks/consultation-document_en.pdf.

If you want to read the amended proposal to include in the Market Abuse Regulation (MAR), please, do click on: http://ec.europa.eu/internal_market/securities/docs/abuse/COM_2012_421_en.pdf.

If you want to read the amended proposal to include in the Directive on criminal sanctions for insider dealing and market manipulation, please, do click on: http://ec.europa.eu/internal_market/securities/docs/abuse/COM_2012_420_en.pdf.

If you want to read the Wheatley review of LIBOR: final report, please, do click on: http://cdn.hm-treasury.gov.uk/wheatley_review_libor_finalreport_280912.pdf