



Proposal of a Regulation on financial benchmarks. November 2013.

The European Commission (EC) has published, on the 18 September, a proposal of a Regulation of the EP and of the Council, on indices used as benchmarks in financial instruments and financial contracts. Internal Market Commissioner, Michel Barnier, said in the proposal presentation that benchmarks were at the heart of the financial system. After the London Interbank Offered Rate (LIBOR) manipulation cases and their consequences for investor, real economy and market confidence, the proposal rules will enhance the robustness and reliability of benchmarks, facilitate the prevention and detection of their manipulation and clarify responsibility for and the supervision of benchmarks by the authorities. The new rules complement the Commission's proposals on MAD/MAR, agreed by the EP and the Council in June 2013, to make the manipulation of benchmarks a market abuse offence subject to administrative or criminal sanctions. The proposal is in line with the principles recently agreed at international level by IOSCO (see edition July 2013 of this International Bulletin) and covers a broad variety of benchmarks, not just interest rate benchmarks but also commodity benchmarks for example. Central Banks are excluded from the scope as they already have systems in place that ensure compliance with the objectives of this draft Regulation.

A benchmark is an index (statistical measure) calculated from a representative set of underlying data that is used to determine the amount payable under a financial instrument of a financial contract, or the value of a financial instrument, or to measure the performance of an investment fund.

The ultimate objective is to ensure the integrity of benchmarks by guaranteeing that they are not subject to conflicts of interest, that they reflect the economy they are intended to measure and that they are used appropriately. Major sections of the proposal are:

1. Benchmark integrity and reliability.

Governance and control of administrators.

The activity of the provision and administration of benchmarks will be subject to prior authorisation and on-going supervision at national and European level.

The administrators will have a well-defined and transparent organisational structure that avoids conflicts of interest where possible and manage them adequately where they cannot be avoided. When any discretion is required in the benchmark process it is independently and honestly exercised. The administrator shall establish and oversight role on all aspects of the benchmark as well as a framework for the control and accountability (including complaints process).

Each Member state shall designate the relevant competent authority for carrying out the supervision duties but coordinated by ESMA. Only critical benchmarks are supervised directly by ESMA as member of the college of supervisors.

Quality of the input data and of the methodologies used by benchmark administrators.

Sufficient and accurate data should be used in the determination of benchmark, so that they represent the

actual market or economic reality that the benchmark is intended to measure. The input data should be transaction data, but if available transaction data is not sufficient to represent accurately and reliably the market or economic reality that the benchmark is intended to measure, input data which is not transaction data may be used provided that such data is verifiable.

The data should come from reliable sources, that is, the administrator shall obtain the input data from a representative panel or sample of contributors.

The administrator shall use a robust and reliable methodology that has clear rules identifying how and when discretion may be exercised in the determination of that benchmark.

Requirements for data contributors.

Contributors to benchmarks should provide adequate data and should be subject to adequate controls that ensure the integrity, accuracy and reliability of the input data.

The administrator will produce a code of conduct which clearly specifies the obligations -among which obligations of handling conflicts of interest are included- and responsibilities of the contributor when they provide input data for a benchmark.

2. Protection for consumers and investors using benchmarks.

The proposal will enhance transparency of the data used to calculate the benchmark and of the way in which the benchmarks is calculated. The administrator shall publish a benchmark statement for each benchmarks explaining clearly and unambiguously what the benchmark intends to measure, the purposes for which it is appropriate to use the benchmarks, the elements of the calculation in relation to which discretion may be exercised and what its vulnerabilities are. The proposal also entrust supervised entities with a suitability assessment of retail consumers in relation to the use of a benchmark.

3. Sectorial requirements and critical benchmarks.

Annexes of the European Commission proposal contain more detailed provisions on commodities benchmarks and interest rate benchmarks. Benchmarks whose input data is provided by regulated venues are released from certain obligations to avoid dual regulation.

Critical benchmarks, that should be included in a list published by the EC, will be supervised by colleges of supervisors, led by the supervisor of the benchmark administrator and including the ESMA. ESMA will be able to decide within the college by binding mediation. Other additional requirements are imposed on critical benchmarks, including power for the relevant competent authority to compel contributions.

4. Administrative measures and sanctions.

The proposal provides for administrative sanctions to be imposed in cases of breaches of the Regulation. Fines on individuals could reach a maximum of at least three times the amount of the profit gained or up to 500.000 euros, and for firms the maximum fines are up to 1.000.000 euros or 10% of their total annual turnover (whichever is greater). Member States remain free to impose even higher maximum sanctions in their national law.

If you want to read the whole text of the proposal, please, do click on:
<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2013:0641:FIN:EN:PDF>

If you want to read the document FAQs, please do click on:
http://europa.eu/rapid/press-release_MEMO-13-799_en.htm?locale=en

