



IOSCO and ESMA-EBA principles for benchmark-setting processes. July 2013.

The Board of the **IOSCO** published, on the 17 of July, the final report on Principles for Financial Benchmarks. This report was drafted by the Board Level Task Force created in September 2012 and chaired by Martin Wheatley (Chief Executive of the FCA) and Gary Gensler (Chairman of the CFTC). The preparatory works included two consultation reports (January and April 2013) that helped to identify certain broad generic risks to the credibility of benchmarks arising from vulnerabilities in methodology, transparency and governance arrangements. These principles are intended to promote the reliability of benchmark determinations and to address benchmark governance, quality and accountability mechanisms. The principles provide a framework of standards whose application and implementation should be, according to IOSCO, proportional to the size and risks posed by each benchmark and/or administrator and the benchmark-setting process. The principles provide for benchmark administrators to publicly disclose their compliance with the principles within twelve months of the publication of the report with the intention of IOSCO reviewing within and 18 month period the extent to which the principles have been implemented. The 19 principles are the following:

1. Overall responsibility. The administrator will retain the primary responsibility for all aspects related to the integrity of the benchmark determination process.

2. Oversight of third parties. The administrator will adopt clearly defined written arrangements setting out the roles and obligations of the parties involved in the Benchmark determination (calculation agent, collection of inputs or benchmark publisher).

3. Conflicts of interest for administrators. The administrator will implement and disclose policies and procedures for the identification, disclosure, management and avoidance of conflicts of interest, to address the vulnerabilities that create incentives for benchmark manipulation. In particular, the Administrator should seek to mitigate existing or potential conflicts of interest created by the ownership or control structure or due to other interests arising from the Administrators' staff or wider group in relation to benchmark determinations.

4. Control framework. The administrator will implement and disclose an appropriate control framework for determining and distributing the benchmark that should include an effective whistleblowing mechanism in order to facilitate early awareness of potential misconduct.

5. Internal oversight. The administrator will establish an independent oversight function (a separate committee can be set up) to review and provide challenge on all aspects of the benchmark determination process.

6. Benchmark design. The benchmark should be designed in such a way that results in a reliable representation of the economic realities of the interest that the benchmark seeks to measure and to eliminate factors that might result in a distortion of the price, rate, index or value of that benchmark.

7. Data sufficiency. The data used should be based on prices, rates, indices or values that have been formed by the competitive forces of supply and demand (active market). It does not preclude from using executable bids

or offers anchored by observable transactions entered into at arm's length between buyers and sellers (observable market), and the use of non-transactional data indexes, such as, volatility indexes.

8 Hierarchy of data inputs. The administrator will set up and publish guidelines regarding the hierarchy of data inputs and the exercise of expert judgment used for the determination of benchmarks.

9. Transparency. (New in comparison with consultation reports) The administrator will publish, with each benchmark determination, a concise explanation sufficient to understand how the benchmark determination was developed and the extent to which it is based upon expert judgment.

10. Periodic review. The administrator will periodically review the conditions in the underlying interests that the benchmark measures to determine whether the interest has undergone structural changes that might require changes to the design of the methodology.

11. Content of the methodology. The administrator will document and publish the methodology used, with sufficient detail to understand how the benchmark is derived and to assess its representativeness, its relevance, and its appropriateness as a reference for financial instruments.

12. Changes to the methodology. The administrator will publish the reason of any proposed material change in its methodology, and procedures for making such changes.

13. Transition. The administrator will have clearly written policies and procedures that address the need for possible cessation of a benchmark, due to market structure change, product definition changes, or any other condition, which makes the benchmark no longer representative of its intended function.

14. Submitters Code of Conduct. The administrator will develop guidelines with the submitters Code of Conduct (if there were submitters), supervise adherence (annually and in case of change of the Code of Conduct) and monitor its compliance.

15. Internal controls over data collection. The administrator that collects data from outsourcing, will have internal controls over data collection process (selection of the source) and data transmission process.

16. Complaints procedures. The administrator will publish written complaints policy by which stakeholders may submit complaints concerning whether a specific benchmark determination is representative, the application of the methodology and other administrator decisions in relation to a benchmark determination.

17. Audits. The administrator will appoint an independent internal or external auditor with appropriate experience and capability to periodically review and report on the administrator's adherence to its stated criteria and the requirements of the principles.

18. Audit Trails. The administrator will keep written records for five years with all the documents necessary for audits.

19. Cooperation with Regulatory Authorities. Relevant documents addressed by these Principles shall be made readily available by the relevant parties to the relevant Regulatory Authorities.

Within **the scope of the EU**, the current initiatives have coordinated their work with the IOSCO works. The **EC** published in 2012 (after the LIBOR manipulation case) a consultation paper and has almost finished a proposal of Regulation. **ESMA and EBA** also launched a consultation report at beginning of the 2012 and have just issued the final report setting out their principles for benchmark-setting processes in the EU, which are very similar to the IOSCO principles above displayed. ESMA-EBA principles were modified compared with the proposed ones in two ways: i) inclusion of a principle for the continuity of benchmarks in order to ensure that contingency provisions are in place if the continuity of a benchmark is at risk, and ii) the data used should represent accurately and reliably the underlying assets or prices, interest rates or other values measured and

should be based on observable transaction entered into at arm's length. The application of the principles will help in the transition to any potential future EU legal Framework for benchmarks and will be reviewed by ESMA-EBA after 10 months.

If you want to read the IOSCO document on Principles for Financial Benchmarks, please do click on:
<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf>

If you want to read ESMA-EBA final report on Principles for Benchmark-Setting Processes, please do click on:
http://www.esma.europa.eu/system/files/2013-659_esma-eba_principles_for_benchmark-setting_processes_in_the_eu.pdf