European Association of Public Banks
-European Association of Public Banks and Funding Agencies AISBL -

European Securities and Markets Authority, ESMA
103, Rue de Grenelle
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- Submitted online via the ESMA website -

15 February 2013

EAPB comments on the EBA-ESMA consultation paper "Principles for Benchmark-Setting Processes in the EU"

Dear Madam or Sir,

The EAPB welcomes the opportunity to participate in the EBA-ESMA consultation concerning principles for benchmarks-setting processes in the EU.

The EAPB believes that a **voluntary contribution** is always difficult to match with tight regulation. However, voluntariness needs incentives to ease the efforts and risks taken by voluntary contributors. It will be important to convince contributing institutions and other market participants to continue to take an active part in setting key benchmarks. Ideally, the number of contributing institutions is high. In cases where the calculation of a benchmark depends on voluntary contributions, **regulation should not act as a deterrent**. On the contrary, the broader the basis is for calculating a benchmark, the less susceptible this benchmark will be to manipulation. It is vital that regulation introduced in the interests of the market does not end up causing market disruption.

A regulation should also **concentrate on those who calculate and administer the benchmarks** and not on the contributors and particularly not the users of the benchmarks. Targeting users of benchmarks and putting obligations on them seems inappropriate and costly in an unjustified way. Any regulation should be built upon the principle of reliance from the perspective of users.

The proposed reform needs to take two aspects into consideration. It is not enough to offer a robust framework for **future** benchmarks. Important existing benchmarks must also be provided with the means of making a smooth **transition**. Furthermore, benchmarks are too different to be targeted by a **"one-size-fits-all"** approach. It does not seem to be appropriate to apply the same regulation to the Euribor-benchmark as to a stock index. The targets, functions and the technical details of the calculations are too different. It is not possible to come up with a single-sized answer. The principle of proportionality should also be respected in this context.

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Finally, we suggest that the principles should be limited to **benchmarks that are systemically relevant**. It seems necessary to find the right balance between necessary regulation and unnecessary cost burden. The consultation paper sets out a scope of application that is practically without limits. Stock indices, regulated markets, MTFs, ETFs etc., should be out of the scope of application.

Answers to the questions:

Q1 [definitions]:

Benchmark: The question whether a published index or figure is used for the determination of any payment or value of any financial instrument depends on the decision of the related counterparties. It is beyond the control of the index' or formula's administrator. Hence, it may happen that a financial institution is publishing an index or formula which is not intended to become a regulated benchmark, but where market participants may start to use it for determination of certain payments or values. Therefore, an index should only be defined as "benchmark" if the producer (administrator) explicitly declares that its index or figure is intended to be used as a benchmark.

Another key aspect is that the principles do not distinguish between existing and new benchmarks. This is of paramount importance for the scope of the principles. One might think of a "new order" as a system that enhances resistance to manipulation. Existing benchmarks cannot be replaced overnight. However, not all of the proposed principles can be applied to existing benchmarks without a certain transition period. Therefore, it should be differentiated between "new benchmark" and "old benchmark".

Benchmarks which are based on prices and traded on regulated trading platforms should be exempted from the application of these principles. The calculation of these indices is based on actual transactions and not on estimates. They are also already monitored on the basis of the MiFID and MAD provisions.

Finally, it is unclear whether the requirements a) and b) are meant additionally, meaning that both prerequisites have to be fulfilled. If meant additionally, it would signify that only indicative benchmarks which function is merely limited to comparisons and which are not integrated into financial instruments are out of the scope of application.

Q2 [principles]:

In principle, a transitional regime should help to restore confidence. However, this requires that the principles can be applied to existing benchmarks.

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Another question is whether benchmarks will be crisis-resilient. "New benchmarks" should be designed to remain robust even in times of crisis. They should be able to continue operating as a benchmark even if the liquidity of the underlying temporarily dries up.

Q3 [general principles]:

A.1: It is unclear how the reliability of methodology should be verified. Only a general requirement is set out here, without clear content.
Actual market transactions would be the ideal basis for a benchmark. However, the main problem of benchmark setting is the lack of actual market transactions in certain cases, but not the extraordinary cases of manipulation.
Existing benchmarks should not be based on "actual market transactions". Current experience with Euribor has shown that these requirements cannot always be met. The interbank money market ran dry due to the financial crisis. Relying on only a limited number of transactions would provide a very volatile benchmark. Furthermore, even a single transaction could alter the fixing. This makes a transaction-based benchmark even more prone to wrongdoing. As a consequence, it is essential to rely on expert estimates to avoid suspending calculations and disrupting the market.
In addition, using transactions in the interbank market would alter the meaning of the benchmark. Using an average over time would not provide one rate for a certain point in time.
For new benchmarks, provision needs to be made for situations in which an otherwise liquid market temporarily dries up. A drying-up should not trigger the immediate suspension of the benchmark with unforeseeable consequences for the market. Furthermore, the liquidity degree can be different from market to market. Therefore the meaning of „underlyings should be sufficiently liquid" should depend on the market circumstances as an absolute meaning of liquidity cannot be defined.

A.2: It needs to be clarified what is meant by the requirement that the process of setting a benchmark should be "independent". Not all aspects of the defined requirements can be met in real life situation. As a principle, avoiding conflict of interest is an important criterion, but contributing firms are generally active market experts in fields related to benchmark setting. Therefore they or their clients naturally have exposure against the benchmark. Excluding such market experts from benchmark setting on the other hand would lead to lower reliability of benchmarks.

A.5: It must be further clarified what is meant by the requirement of "contingency provisions" in case of a market interruption.

Question 4 [firms involved in benchmark data submissions]:

B.1+B.2: The principles should focus on the submission process and internal control within the contributing firm. The principle of proportionality should be added to the general

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principles. When it comes to voluntary contributors, incentives need to be created in order to ease the efforts and risks taken by the contributors.

B.3+B.4: The "management" of conflicts of interest is interlinked with the question of how many contributors are contributing to a benchmark. For contributors conflicts of interest will in most cases persist. The higher the figure of contributors is, the lower the impact of the single contributor and the lower the relevance to target possible conflicts of interests within one contributor.
The threefold approach to conflicts of interests in MiFID (avoidance of conflicts of interests, if this is not possible management of conflicts of interests, if this is not possible disclosure of conflicts of interests).
This threefold approach would also be appropriate if conflicts are not in any case avoidable. In the context of interbank-interest-rate-quote-contributions it seems nearly impossible to avoid conflicts of interests, given the fact that the quotes regularly stem from the traders, who are not only contributors of quotes but acting on behalf of the banks as market participants on money markets.

B.7: The term of "appropriate training and development programmes" needs to be precised.

B.8: Problems could arise when requiring a comparison with actual, verifiable transactions for existing benchmarks. Since data submissions for Euribor are currently based on expert estimates, transaction-based verification is not feasible. Instead, a "plausibility check, to the extent possible" could be possible.

B.9 seems to be superfluous.

B.10: Not all firms have a whistleblowing hotline. It would be excessive to require one to be set up solely for the purposes of benchmark compliance. If at all, it should be sufficient for the benchmark administrator to have a whistleblowing mechanism in place.

B.11: A public confirmation of compliance would establish liability under criminal law and give rise to civil liability vis-à-vis the public as a whole. This would generate liability risks on an unforeseeable scale. The introduction of a confirmation of compliance would act as a deterrent and achieve the opposite of the objective to strengthen benchmarks by encouraging broad participation. This principle should therefore be dropped.

Question 5 [benchmark administrators]:

It is specifically important that errors/irregularities are quickly taken up to discontinue any adverse practice at an early stage. The administrator could provide training opportunities to support the individual contributors to develop common implementation modes.

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C.2: The EAPB agrees with the inclusion of "independent" members in governance functions. Consideration should also be given to involving public bodies, such as the ECB, in the supervision of important benchmarks.

C.9: A benchmark administrator neither has the capabilities nor should it have the authority to ensure implementation of principles within the entity of a contributing firm.

C.10: We would like to point out that a transaction-based verification is not feasiblesince data submissions for Euribor are currently based on expert estimates. Instead, a "plausibility check, to the extent possible" could be possible.

C.14 seems to be disproportionate and should be deleted.

Question 6 [benchmark calculation agents]:

See the comments above. The calculation method should be clear and the administrator should control the activity of the calculation agent. D.4 and D.6 are not necessary.

Question 7 [benchmark publishers]:

See the comments above. The principles seem to be consistent, although we would like to point out that in connection with publication of benchmarks no deficiencies have occurred.

Question 8 [users of benchmarks]:

These principles are the most wide-ranging as they affect potentially all issuers or sellers. It would effectively require a yearly review of all benchmarks used in products for the seller or issuer. Furthermore, it is unclear how the requirements should apply to re-sellers (or even re-sellers that rebrand the product). The obligations to be imposed on benchmark users are excessive. The EAPB is of the opinion that benchmarks users are not in a position to comply with these principles.

F.2: Users should generally be able to assume that benchmarks which are subject to regulatory scrutiny and possibly even certified provide a reliable reflection of the market. Users are not in a position "to ensure" that the benchmark administrator and benchmark calculation agent are in compliance with applicable principles. This should be the responsibility of regulators.

F.3: The principle is very far-reaching, obliging users to use alternatives "in the event of occasional operational problems, or other market disruptive events, which lead to the

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benchmark not being reliable." This would require a material assessment which should be undertaken by a central body, not by each individual user. Ideally, it should be the administrator, possibly in consultation with supervisors, who is responsible for deciding that an emergency exists. Legislation governing stock exchanges has provisions along these lines to cover cases where quotes are suspended. These could be used as a basis for contingency planning. Generally speaking, contingency measures should be the responsibility of the benchmark administrator but not the benchmark user.

To sum up, the EAPB thinks that this chapter on benchmark users should be dropped.

Question 9 [practical application]:

The principles react to the past manipulations with LIBOR. Requirements towards publishers and users are inadequate and they cannot be justified by the past experience. With respect to Euribor, several of the principles could not be adequately applied at present. With respect to basing future benchmarks on actual transactions it has to be taken into account that unforeseeable events and developments may cause circumstances in which the relevant transactions may no longer occur for an extended period of time or where the number of transactions qualifying may be too little to serve as a reliable basis for the benchmark. Projections and expert evaluations/assessments still need to be admissible.

Question 10 [continuity]:

If the principles were applied in their entirety to existing financial benchmarks, considerable difficulties would arise. They should therefore apply to new benchmarks only.

This issue goes beyond the ability of single market participants to ensure. Eventually there needs to be an institution that can make a final determination what replaces a benchmark if ineffective. For example, a standing panel for each benchmark could be established that has the right to decide on the succeeding benchmark with subsequent universal application.

The idea of requiring benchmarks and their calculations to be **verified by actual transactions** is specifically problematic. For a transitional period at least, we need to continue with expert estimates, which can be subject to plausibility checks, but not to transaction-based verification.

The various benchmarks are referenced, used or relied on, directly or indirectly, in a great variety and multitude of contracts, financial instruments and transactions. Each benchmark serves a specific economic function or intends to reflect a specific and unique economic value. A benchmark can thus only be **exchanged for another benchmark where the underlying economic values are sufficiently comparable**. Changes to the new underlying

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method of calculation, definition or composition of a benchmark must not alter the nature of a benchmark to such an extent that it may no longer be suited to serve its original function.

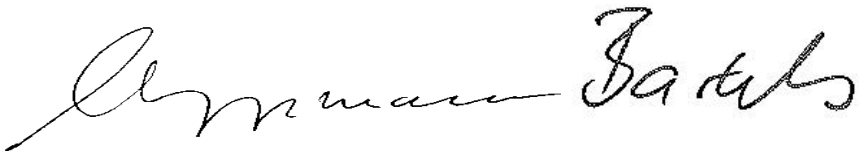
It would be extremely challenging from a practical and legal perspective to procure a legally binding and enforceable replacement of an existing benchmark or a materially altered benchmark since this would **require the identification and subsequent amendment of all agreements and replacement of financial** instruments containing the reference to the benchmarks in question.

Should the introduction of the new principles result in the **change of the regularity of the publication of the benchmark**, legal uncertainty might require fundamental changes in the business relationships. It should therefore be ensured that the application of the new principles will not lead to the change of the regularity of the benchmark publications and the legal continuity of those contractual relationships concerned in the time of the entry into force of the new principles should be explicitly stated.

The EAPB expects that in short term it will not be possible to fully replace an existing benchmark by another or materially amend the manner in which the benchmark is calculated, defined or composed. Rather, any such replacement or amendment will require an extended **transition period** during which it will be necessary to ensure the continuation of any existing benchmark. This also means that new regulatory requirements for benchmarks have to provide for such transition periods in respect of existing benchmarks.

Should you have additional questions or comments, please do not hesitate to contact us.

Kind regards,



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The European Association of Public Banks (EAPB) represents the interests of 36 public banks, funding agencies and associations of public banks throughout Europe, which together represent some 100 public financial institutions. The latter have a combined balance sheet total of about EUR 3,500 billion and represent about 190,000 employees, i.e. covering a European market share of approximately 15%.

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