



Set up in 1990, the Czech Banking Association (CBA) is the voice of the Czech banking sector. The CBA represents the interests of 37 banks operating in the Czech Republic: large and small, wholesale and retail institutions. The CBA is committed to supporting quality regulation and supervision and consequently the stability of the banking sector. It advocates free and fair competition and supports the banks' efforts to increase their efficiency and competitiveness.

We appreciate the opportunity to comment on ESMA and EBA Joint Consultation Paper relating to **PRINCIPLES FOR BENCHMARKS-SETTING PROCESSES IN THE EU REGULATION (JC/CP/2013/01)**. Our response is divided into two parts – general comments and response to questions.

General comments

Self-regulation vs. Regulation

In case of a general common interest of a benchmark we think that a voluntary contribution is difficult to match with tight regulation. As we see it with the example EURIBOR – some former contributors already ended their voluntary contribution. We want to underline that voluntariness needs incentives to cushion the efforts and risks taken by voluntary contributors, otherwise we are skeptical that EBA/ESMA's proposal will work out.

On the other hand we very well understand and agree that the regulator puts some effort in the field of benchmark-setting under the impression of the LIBOR-issue and that action is needed to limit situations of abuse.

Scope of application

We would welcome an appropriate limitation of the scope of application of the proposed standards on benchmark-setting. We think, that e.g. in the fields which are already highly regulated a new regulation does not seem necessary. E.g. one limitation could be that in the case benchmarks are calculated or administered by regulated entities an additional regulation seems superfluous.

Additionally the principles should be limited to such benchmarks that are systemically relevant. Only these seem to have real relevance. It seems necessary to hit the right balance between necessary regulation and unnecessary bureaucracy. We have to take into account that the consultation paper sets out a scope of application that is nearly borderless, targeting at each and every possible benchmark. We propose to come up with a system of identification of systemically relevant benchmarks and only regulate these benchmarks.

We think that for instance stock indices, regulated markets, MTFs, ETFs etc., should be out of the scope of application.

The third issue in the context of scope of application is linked to the definition of “benchmark”. We assume that a) and b) are meant additionally, meaning that both prerequisites have to be fulfilled to hit the definition. Therefore we suppose a) and b) are to be read with an “and”. This would mean 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.

The fourth issue in the context of the scope: We think that the regulation should concentrate mainly on those who calculate and administer the benchmarks and not on the contributors and users of the benchmarks. From our point of view targeting users of benchmarks and putting obligations on them seems inappropriate and setting the whole system at a new stage of bureaucracy. What are e.g. the consequences for the users of stock indices or of EURIBOR in the context of retail mortgage loans? We think that any regulation should be built upon the principle of reliance from the perspective of users.

Finally we want to underline our belief that “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 technical details of the calculations are too different. We do not think that it is possible to come up with a single-sized answer. In this context we want to underline also the principle of proportionality that is also to be respected in the context of benchmark-setting.

Conflict of interest

We think that the question of the “management” of conflicts of interest is interlinked with the question how many contributors, independent from each other, are contributing to a benchmark. Although we think that for contributors conflicts of interest will in most cases persist, we are of the opinion that the higher the figure, the lower the impact of the single contributor, the lower the relevance to target possible conflicts of interests within one contributor. This has clearly shown the LIBOR-issue. From our point of view one of the biggest problems in this respect was the low number of contributors, which facilitated manipulation. In order to ensure the EURIBOR being the European benchmark interest rate these issues must be taken into consideration.

The second issue in this context: We think that an issue comparable to the MiFID structure could be implemented also in the field of benchmark setting. This is the threefold approach to conflicts of interests:

1. Avoidance of conflicts of interests, if this is not possible:
2. Management of conflicts of interests, if this is not possible:

3. Disclosure of conflicts of interests.

We think that this threefold approach would also be appropriate for the current issue the more so if conflicts are not in any instance avoidable. In the context of EURIBOR quote contributions it seems – from an organizational point of view – 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.

Response to questions

Q1: Definition of the activities of benchmark setting

Do you agree with the definitions provided in this section? Is the list of activities complete and accurate?

Definition of the “benchmark”

Regarding the definition of a “benchmark”, please refer to our general remarks under the above section Scope of application.

We would like to highlight that benchmarks (equity and bond indices), where the calculation is based on prices, traded on regulated markets, multilateral trading facilities (MTF) or, after implementation of the MiFID 2, on organized trading facilities (OTF), should be exempted from application of these principles. The calculation of these indices is based on actual transactions and not on estimations like EURIBOR. All transactions on regulated markets, MTFs and OTFs are anyway monitored and analyzed because of the MiFID and the MAD.

We also think that hedge funds concerned principles should be governed separately as product specific rules. Considering that hedge funds are not obliged to publish their performances, the data published by the hedge fund may differ from its real performances.

According to the definition of a “benchmark” any index or figure may become a benchmark regulated under these principles, if any amount payable under any financial instrument or the value of any financial instrument is determined by reference to such index or figure.

The question whether a published index or figure is used for determination of any payment or value of any financial instrument, or not, entirely depends on the decision of parties of a specific contract (financial instrument). Such decision is entirely beyond the control of the administrator of the index or formula. So, it may happen that a financial institution is publishing some index or formula, which is not intended by such institution to become a regulated benchmark, however some market participants may start to use it for determination of certain payments or values.

We are of the opinion that the producer (administrator) of any index or figure should have the right to decide whether its index or figure is intended for usage as a benchmark (any administrator as the owner of copyright should have the right to decide about the usage of index or figure published by it). Only if it is explicitly declared by the producer (administrator) that its index or figure is intended for usage as a benchmark (i.e. for the purpose of determination of some payments or values), only in such case the administrator should be subject to the proposed principles.

Definition of the “benchmark user”

The definition of the “benchmark user” states that a financial market participant uses a benchmark “... as a reference to financial transactions....”. We believe that “reference” does not necessarily mean that it is used for calculating a price; it could also include that it is used as a “reference benchmark” in the narrowest sense, i.e. a comparison. This would inappropriately extend the range where one becomes a “benchmark user”.

In general we do not think that benchmark users should be covered by these guidelines. In this regard, please also refer to our general remarks under the section Scope of application, as well as to our answer to Q8.

Q2: Principles for benchmarks

Would you consider a set of principles a useful framework for guiding benchmark setting activities until a possible formal regulatory and supervisory framework has been established in the EU?

The framework is a reasonable one, but the issues are in fact hidden in details, as we would like to point out as follows:

- When is a benchmark “precisely defined”?
- When is a group of underlyings “representative”? From a general approach, it is a good principle to use actual transactions, but what would be used as a guideline when actual transactions need not be used (which would imply illiquid markets?)
- The conflict of interest issue is an overriding one. Any bank that contributes to a benchmark will routinely have exposure to it. Please also refer to our introductory general remarks under the section Conflicts of Interest.

However, if it is intended to establish a legal regulatory framework for benchmark setting, we believe that it is not necessary to create this set of principles.

Q3: General principles for benchmarks

Do you agree with the principles cited in this section? Would you add or change any of the principles?

Comments to A.1 Methodology

It is unclear how the reliability of methodology should be verified. Only a general requirement is set out here, without clear content.

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.

We agree that actual market transactions should be optimally a 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.

However, the principles do not offer any solution for this basic problem. This is the main deficiency of the principles and without its solution the real contribution of principles will be very limited.

Comments to A.2 Governance Structure

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.

Comments to A.3 Supervision

In this context, please refer to our general remarks under the section Self-regulation vs. Regulation.

Comments to A.5 Continuity

It must be further clarified by EBA/ESMA what is meant by the requirement of contingency provisions in case of market interruption.

Q4: Principles for firms involved in benchmark data submissions

Do you agree with the principles cited in this section? Would you add or change any of the principles?

Comments to the general principles

The principles should focus on the submission process and internal control within the contributing firm. Other aspects (e.g. complaints management) should be excluded from the principles.

In our view, the principle of proportionality is to be respected and should therefore be added to the general principles. With respect to EURIBOR this would contribute to ensure that a further reduction of panel banks could be stopped.

Especially when it comes to voluntary contributors, incentives need to be created in order to cushion the efforts and risks taken by the contributors.

Regarding EURIBOR, such incentives could be a reduction of RWAs for granted interbank-loans, or an ECB-quality as a collateral in order to re-establish an interbank money-market as a basis for a volume-based EURIBOR. This would not lead to a disadvantage in the liquidity ratios.

Comments to the supporting principles

The principles are formulated too vague and give local regulators far too much room for interpretation.

As to principles B.3 and B.4, the three core MiFID-principles about conflict of interest management (identification, management, disclosure) should also be applied and mentioned explicitly.

The implicit request, that trading staff which submits the contributing rates, should avoid any conflicts as a consequence of their contribution, could in practice lead to the situation, that contributing rates have to be submitted from other than trading staff, with the consequence, that the quality of the contributing rates would suffer.

Please also refer to our comments to Q3, point A.2 on conflicts of interest, as well as to our introductory general remarks on conflicts of interest.

As to principle B.7, the content of required training and development programs is unclear. We would ask EBA and ESMA for further clarification.

Principles B.9 and B.10 seem to be superfluous.

The requirement in B.11 should be deleted; its necessity seems to be unclear. We doubt the overall effectiveness of the public disclosure of compliance with these principles, as this seems to distract attention from other important issues.

In our view it is important to spot and define the sources of data, as well. Firms should be permitted to define them in internal rules. Such sources cannot be defined only as reference to public independent sites.

Q5: Principles for benchmark administrators

Do you agree with the principles cited in this section? Would you add or change any of the principles?

In general we agree with the principles applicable to the administrator. It is specifically important that errors/irregularities are quickly taken up to discontinue any adverse practice at an early stage.

However, principles C.13 (whistleblowing) and C.14 (disclosure of compliance with principles) seem to be disproportionate and should be deleted.

The administrator should also provide training/workshop opportunities to support the individual contributors to develop common implementation modes.

Q6: Principles for benchmark calculation agents

Do you agree with the principles cited in this section? Would you add or change any of the principles?

The calculation method should be clear and the administrator should control the activity of the calculation agent, i.e. the application of the calculation method.

In fact the question arises if the functions agent and administrator should be split.

We doubt that for the calculation agent especially the principles D.4 (whistleblowing) and D.6 (disclosure of compliance with principles) are necessary.

Q7: Principles for benchmark publishers

Do you agree with the principles cited in this section? Would you add or change any of the principles?

The principles seem to be consistent, although we would like to state that in connection with publication of benchmarks no deficiencies have occurred.

Q8: Principles for users of benchmarks

Do you agree with the principles cited in this section? Would you add or change any of the principles?

These principles in fact are the most wide-ranging as they affect potentially all members of the financial community that issue or sell. This would not only effectively require a yearly review of all benchmarks used in products for the seller or issuer. It is unclear how the requirements as set out in the paper should apply to re-sellers (or even re-sellers that rebrand the product).

We doubt that the benchmark user as defined in the paper can be in a position to comply in any case with this recommendation.

Especially, we strongly object to the requirement for a user in F.1 to notify any potential irregularities to the administrator or the competent authorities. Moreover, we do not agree with principle F.2, as it should not be the responsibility of benchmark users to ensure that the benchmark administrator and the benchmark calculation agent comply with the applicable principles. This should be the responsibility of regulators rather than of benchmark users.

We also doubt that one benchmark user can provide for a contingency plan unless it is developed by a central institution.

Additionally, we would like to refer to our comments under Q1 on the definition of the benchmark user above, as well as to our general remarks under section Scope of application.

Considering the arguments herein before mentioned, we think that this chapter on benchmark users should be deleted.

Q9: Practical application of the principles

Are there any areas of benchmarks for which the above principles would be inadequate? If so, please provide details on the relevant benchmarks and the reasons of inadequacy.

The principles react to the past manipulations with LIBOR. Requirements towards publishers and users are inadequate and they can – in our view – not be justified by the past experience.

Please also refer to our general remarks under section Scope of application.

Q10: Continuity of benchmarks

Which principles/criteria would you consider necessary to be established for the continuity of benchmarks in case of a change to the framework?

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 (legal wording would in fact require that – usually the most appropriate and closest to the original benchmark – however, this will not resolve an issue as large as EURIBOR or even domestic benchmarks as eventually courts would decide on the contract terms).

It would be reasonable to establish a standing panel for each benchmark that has the right to decide on the succeeding benchmark (much in the sense of an arbitration court) with subsequent universal application.

Besides, the following criteria should be considered with regards to continuity:

As the benchmark frameworks are not detailed in the benchmark references, the simple reference manifests in one particular number to be applied as benchmark reference. Any change at principle level therefore might not cause major disruption to the existing benchmark-referenced contracts, presuming that the new principles do not mean in parallel determining changes in the applicable numbers at nominal level.

However, shall the introduction of the new principles result in the change of the regularity of the benchmark publication, this could lead to legal uncertainty and may require fundamental changes in the business relationships. Therefore we suggest to ensure:

- that the application of the new principles will not lead to the change of the regularity of the benchmark publications on the one hand; and
- for a full legal certainty, to explicitly state the legal continuity of those contractual relationships concerned in the time of the entry into force of the new principles on the other hand.

We hope that our response to the Joint Consultation Paper is sufficiently clear and our views are helpful for preparing principles focused on reference rates and other benchmarks setting processes in the EU.