



Principles for Benchmarks-Setting Processes in the EU

RVS response to the ESMA EBA Consultation Paper ESMA/2013/12

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1 Executive summary

We are pleased to submit this document as our response to the ESMA EBA Consultation Paper (ESMA/2013/12) on the Principles for Benchmarks-Setting Processes in the EU.

RVS endorses and agrees with ESMA/2013/12 regarding benchmark processes and is of the opinion that all benchmarks should be based upon a transparent methodology which makes best use of both evidential transaction data and other sources where no trades are in evidence. The process should be automated and based upon an agreed set of independently validated rules. The rules and approach should be governed by an advisory panel of eminent independent experts.

Since its inception in 2009, RVS has been actively engaged with the financial services industry to create a series of transparent, end-of-day benchmarks on a daily basis for use in risk, capital, P&L and other calculations on a centre by centre basis “following the sun”. The RVS philosophy is based on principles of accuracy, transparency and independence. These principles have been endorsed by a wide range of stakeholders including market practitioners, self-regulatory organisations and authorities.

Further description of our services can be found in Appendix 1.

2 Response and commentary

RVS's perspective is that benchmarks of financial market instruments should be globally consistent, independently governed and wherever possible validated by evidential data to substantiate them. This applies whether the valuation uses a prudential, mark-to-market or fair value approach.

The establishment of such benchmarks was the reason RVS was created. This perspective and background leads us to make the following informed observations.

Question 1: Definition of the activities of benchmark setting

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

Yes we agree with definitions, although we note that there are some minor differences of nomenclature compared to consultations by other regulators eg the FSA Consultation Paper on the Regulation and Supervision of Benchmarks¹ and the IOSCO Consultation Report on Financial Benchmarks² where in the latter, the phrase 'Benchmark Submitter' is used instead of 'Contributing firm' and 'Benchmark User' is similar to 'Market Participant'.

Question 2: 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?

Yes, we would consider a set of principles a useful framework, provided they are aligned with similar such principles being worked on by organisations such as IOSCO. We would anticipate such an alignment will occur as we understand there is international cooperation across jurisdictions and regulators,.

Question 3: General principles for benchmarks

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

Yes we agree with the principles as outlined in this Consultation Paper.

We would also add that embedded within these principles should be an analysis of the hierarchy of quality of contributions, ranging from observable transactions supported by evidential data, committed and uncommitted quotations through to expertise-based judgement. Further, Benchmark Administrators should be required to calculate and publish a range of standardised quality metrics, relevant to the specific market but which may include confidence and liquidity indicators, frequency and size of transactions, in accordance with industry and/or regulatory defined rules.

Question 4: 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?

Yes we agree with these principles.

We would add that there should be frequent internal audits of Contributing firms and regular external audits too.

¹ CP12-36 <http://www.fsa.gov.uk/static/pubs/cp/cp12-36.pdf>

² CR01/13 <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD399.pdf>

Question 5: Principles for benchmark administrators

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

Overall, we agree with the principles, but we would recommend the following supplements:

Firstly, in Supporting Principle C3, there should be an explicit mention of the hierarchy of preference for the different kinds of contribution, as described in the Wheatley Review of LIBOR³ and other regulatory analyses of financial benchmarks. Specifically, the principles should prioritise contributions as follows from highest priority to lowest:

- Observable transactions supported by other evidential data;
- Committed quotations (bids and offers) which means that a firm will contract to that price;
- Uncommitted quotations where the bid/offer is at best indicative of the price which will be contracted; and
- Judgements based on expertise or other manual processes not derived directly from actual trades.

Contributions should also be segregated and sorted according to firm type, size, relative position in the market and other key metrics to support the veracity of the data.

Also, preference should be given to contributions from Contributing firms where all data within a category is submitted rather than allowing a Contributing firm discretion as to which trade data is provided to the Benchmark Administrator.

Secondly, in Supporting Principle C6, care should be taken as to the level of mandated disclosure of the Benchmark methodology to prevent Contributing firms to 'game' the Benchmark Calculations. While the principles of the methodology can be disclosed, there needs to be some inherent elements held back from disclosure which are used within the Benchmark so that gaming, or more malicious behaviour, is prevented.

To be clear, RVS believes strongly in the openness and transparency of benchmarking activities but it believes this important principle needs to be balanced against the need to ensure the credibility of the benchmark across all Benchmark Users.

Finally, there should be an explicit requirement for the Benchmark Administrator to be governed via an oversight committee, composed of independent individuals and experts who represent all relevant stakeholders. One of its functions will be to ensure that the Benchmark continues to be fit for purpose to Benchmark Users in general.

Question 6: Principles for benchmark calculation agents

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

Yes, we agree with the principles outlined in this section.

Question 7: Principles for benchmark publishers

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

Yes, we agree with the principles outlined in this section.

Question 8: Principles for users of benchmarks

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

Yes, we agree with the principles outlined in this section.

³ http://cdn.hm-treasury.gov.uk/wheatley_review_libor_finalreport_280912.pdf

Question 9: 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.

We believe the principles outlined in the Consultation Paper should be able to be applied to all financial benchmarks irrespective of whether the Contributing firms and Benchmark Users are financial institutions.

Issues might arise where regulatory compulsion is required within a jurisdiction where the organisations being compelled are not currently regulated. This may prove to be the case in certain commodity benchmarks where Contributing firms are often corporates rather than financial institutions.

Question 10: 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 can only be answered with reference to the particular circumstances under which a benchmark framework is being altered, the systemic impact of alterations to that framework and the specific data elements associated with the Benchmark Calculations.

In general, identifying all the dependencies on any particular benchmark is extremely challenging, and any change to a benchmark's calculation methodology is likely to have far-reaching consequences in the real economy. In some cases, particularly where there is significant reliance on the benchmark by retail clients (e.g. residential mortgages or domestic electricity supply contracts), the original calculation methodology should be maintained, in parallel with the revised one, for a substantial period of time to allow the dependency on the old benchmark to reduce naturally.

3 Appendix 1 - RVS QED Benchmarks

RVS has created a global industry benchmark service for independently and transparently validating End of Day (EoD) and other rates, prices and curves. It was designed to be the single industry source for benchmark rates for all time zones and centres. The service has been incubated in Australia prior to a global roll out which started in 2012.

Rate Validation Services Qualitative Evidential Data (RVS QED) Benchmarks have the following key characteristics to ensure complete accuracy and transparency:

1. The daily Benchmarks are, as much as possible, based upon actual transaction or evidential data:
 - RVS software analyses the economic elements of confirmed trade data at various time points during the day. Volume data is compared to each bank's source systems to ensure the completeness of transaction data analysis.
 - Each benchmark is created using industry agreed Rules, Conventions and Policies which are signed off by an independent panel.
 - The independent panel may be made up of industry experts, academics, regulators and other eminent individuals depending on the characteristics required by the jurisdiction.
 - The service is independently audited on a regular basis to ensure that the construction of all benchmarks is in accordance with the agreed Rules, Conventions and Policies. The audit is made available to regulators and market participants to ensure complete transparency.
2. The construction of the benchmarks, based upon industry Rules and Conventions, is completely transparent but individual bank contributions are currently only accessible to regulators in order to protect the privacy of each contributing bank.

We believe RVS QED ensures the accuracy required and provides the transparency of the collection, calculation and governance of each benchmark to allow for each country's specific requirement to be met.

RVS QED underwent a proof of concept with 18 of the world's largest banks in the UK in September 2012, which will result in a full launch of the service in early 2013. A similar service has already been delivered by RVS in Australia, where the company has been operating for three years.

4 Document control

If you have any queries regarding the information in this document, please contact:

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Distribution

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