

22 November 2013

AmCham EU Position on Benchmarks

Following the adoption of both the International Organization of Securities Commission's (IOSCO) Principles for Financial Benchmarks and the European Commission's legislative proposal for a Regulation on Indices and Benchmarks, the American Chamber of Commerce to the European Union (AmCham EU) is pleased to submit its position on Benchmarks.

The Commission's proposal, through its broad scope, will impact all 147 members of AmCham EU, many of whom are not financial services firms. The proposal reaches well beyond capital markets. We therefore urge the European co-legislators to call for an independent comprehensive impact assessment of the proposal, particularly focusing on the energy and raw material markets, the shipping industry and other non-financial activities, before regulation impacting these markets is introduced. The characteristics of these markets, and the suppliers of benchmarks to those markets, are very different from capital markets. Comprehensive impact assessments are necessary to avoid unintentional damage to these markets.

By their very nature benchmarks and indices are used globally. European regulation should be fully aligned with the G20 commitments and the principles developed by the relevant international organisation, including IOSCO, the International Energy Agency and the International Energy Forum. AmCham EU is particularly concerned about any extra-territorial application of EU rules.

1. Financial Benchmarks

a. Scope

AmCham EU welcomes reforms to significant benchmarks such as Libor and Euribor to restore market confidence. We support a targeted and specific scope for a European regulation on financial benchmarks that should be developed to reflect a consistent international approach. Clarity on scope as well as on the varying levels of regulatory requirements that apply to different types of benchmarks is critical for all stakeholders, including regulators. Any global benchmark must have a governance framework that is utterly impartial and has sophisticated scrutiny mechanisms with the ability to identify manipulation and the teeth to impose appropriate sanctions. As a first step, those involved in the

governance must be free from conflict of interest and the structures and decision making process must be transparent and auditable. The governance, scrutiny and enforcement regimes for a global benchmark must satisfy regulators globally.

Where a benchmark sponsor or participant is already being regulated by a financial regulator, then that regulator should oversee the implementation of the standards in a manner that reflects the significance of the benchmark being regulated. The level of regulation of benchmarks should also remain proportional to their relative importance to the financial system and any framework must be carefully calibrated¹. In addition, it is important to take account of the distinction between key public benchmarks, that are primarily used for purposes of pricing a broad range of financial instruments or contracts, and benchmarks in the broader sense (including proprietary indices). In short, not all indices should be regarded as “public goods” and this should be reflected in the design of the regulation.

AmCham EU is also concerned about maintaining the freedom of the press and the right to freedom of expression. The European Commission’s proposal does refer to those key principles in the explanatory memorandum, but there are no specific safeguards in the articles of the proposal that guarantee that media activities remain outside the scope of the Regulation. Compromising editorial freedom may not only endanger a democratic and a fundamental constitutional right; the potential regulation of media sources could also bring to an end the publication of prices and some financial data reporting. This would negatively impact the European Commission’s drive towards increased transparency in financial markets.

b. Accurate and sufficient data as a solid base for robust benchmarks

AmCham EU believes that suitability, transparency, reliability, predictability, appropriateness of data are all critical to financial benchmarks. AmCham EU welcomes the fact that the European Commission’s proposal reflects the IOSCO principles’ guidelines on hierarchy of data inputs and expert judgement used for the determination of benchmarks. Provided that data sufficiency and an active, highly liquid market exist, live prices (i.e. committed bid-offer quotes) and/or traded rates and observable transactions would be the best inputs. Other market information or expert judgment may be more suitable in low

¹ An example of this approach are the GFMA Updated Benchmark Principles of 20 November 2012, <http://www.gfma.org/Initiatives/Market-Practices/GFMA-Provides-its-Updated-Principles-for-Financial-Benchmarks-to-the-Global-Regulatory-Community/>

liquidity markets where transactions may not be consistently available each day. The value of data on previously-executed transactions can quickly become stale and even illiquid assets must be priced on a regular basis. Habitually or spasmodically illiquid markets which are priced from transactions can exhibit high levels of volatility which might not be regarded of representative of the value of underlying assets. Moreover, many liquid markets, for example in equities, are valued on an unweighted last trade basis where unrepresentatively small retail trades can give an unrepresentative view of the marker. Thus there are exceptions which again demonstrate the principle that the most appropriate approach (in the case of defining input data) needs to be determined on a benchmark by benchmark basis.

AmCham EU also urges further clarity around the transparency of the input data regime (Article 16). Provisions to publish the input data used to determine benchmarks immediately after publication of the benchmark should take into account that administrators in many cases do not own the intellectual property for prices. Such ownership is often held by exchanges, which are barred from immediately publishing the transaction data by their licensing agreements and contracts. In certain cases, publication of input data should be delayed with the option to withhold it indefinitely to avoid contractual disputes. Any provisions to publish input data should also be carefully calibrated to ensure the viability of benchmarks, without jeopardising its intellectual property rights and data sufficiency.

c. Methodologies

AmCham EU believes that investor protection is crucial in restoring trust to financial benchmarks. Nevertheless, we are concerned that the proposal requires administrators to identify circumstances when their benchmarks become unreliable. Some have argued that this may be an invitation to litigation, not just against administrators and contributors but against any financial services companies offering products based on a benchmark, and between counterparties to the large number of bilateral Over The Counter (OTC) contracts based on benchmarks.

Administrators are not able to control who uses their information and for what purpose, unless extremely strict restrictions are placed on how the data may be accessed. Once data is in the public domain, administrators cannot track who is viewing it and how it is being used. This is why data carried by data vendors is subject to extensive disclaimers.

2. Equivalence & transitional provisions

Benchmarks are of a truly global nature. AmCham EU is concerned that the European Commission proposal effectively bans third country administrators from providing benchmarks to EU customers until the EC has adopted an equivalence decision in respect of that third country. For example, market actors may require hedging Yen or Renminbi floating- or fixed rate loans using third country benchmarks to manage their risks. There is a real risk, supported by evidence of previous EC initiatives, that equivalence determinations will not be made in time, as all signs are that third countries will move at a slower pace than the European Union in introducing benchmark regulation, if they will introduce any regulation at all. This may have highly disruptive implications for EU users of third country benchmarks, preventing them from managing risk. Moreover, the application of a restrictive equivalence approach could provoke retaliatory reciprocal measures. Therefore, AmCham EU believes it is essential that an appropriate transitional framework is in place that provides for continuity until such determinations are made.

IOSCO will publish a review of the implementation of its principles on financial benchmarks in October 2014. Earlier this year the Financial Stability Board (FSB) established an “Official Sector Steering Group” (“OSSG”) to coordinate and maintain the consistency of reviews of existing interest rate benchmarks. AmCham EU welcomes these reviews and regards them as a litmus test for a global enforcement regime. We are concerned the EU would be front-running certain provisions of the OSSG work and the IOSCO review by unilaterally establishing equivalence provisions for benchmarks as proposed by the European Commission and undermining the international bodies in their tasks.

The transitional provisions (Article 39) present certain risks of market disruption. In particular, the use of benchmarks not complying with the requirements of the Regulation is prohibited unless changing the benchmark would result in a force majeure event, frustrate or otherwise breach the terms of any financial contract or financial instrument which reference that benchmark. While this provision is welcome, we note that it will be very difficult to demonstrate beyond doubt ex-ante that contract frustration would occur if the benchmark were changed. Also, no transitional period seems to be offered for benchmarks established outside of the Union.

3. Commodity Benchmarks

AmCham EU supports international initiatives to ensure robust and reliable commodity benchmarks and support confidence. We are

committed to the IOSCO principles for Price Reporting Agencies (PRAs) of 5 October 2012, as reaffirmed by IOSCO Principles for Financial Benchmarks in July 2013, which paid due regard to the specificities of the oil and wider commodity markets. European legislation should fully reflect and not exceed these IOSCO principles for PRAs.

By way of example, AmCham EU is concerned by the restrictions on the use of front office data (Annex I, 8), imposed by the proposal, on administrators of commodity, and other specialist benchmarks. These restrictions would impair the administrators' ability to access data and may even force a number of benchmarks to be shut-down, as some contributors will find it difficult and economically unviable to comply with the requirement².

Additionally, the PRA Principles were calibrated with immense care to encourage the voluntary provision of information by market sources in commodity markets to journalists working for the PRAs. There was an active dialogue between all the stakeholders involved, including the IEA, IEF and OPEC. The PRA Principles are now undergoing an 18 month review process and will, if required, be further elaborated upon by IOSCO, again in collaboration with the International Energy Agency (IEA), the International Energy Forum (IEF) and the Organization of Petroleum Exporting Countries (OPEC).

We are unaware whether the Commission has been assisted by the IEA, IEF, OPEC and other national or international expert bodies, including the Agency for the Cooperation of Energy Regulators (ACER), to gain an understanding of the distinctive characteristics of oil, energy and other commodity markets. Both IOSCO and, more recently, the Office of Gas and Electricity Markets (Ofgem), the UK energy regulator, have drawn particular attention to the voluntary nature of contributions and the risk that inappropriate regulatory intervention could decrease contributions by market sources, leading to reduced market transparency.

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AmCham EU speaks for American companies committed to Europe on trade, investment and competitiveness issues. It aims to ensure a growth-orientated business and investment climate in Europe. AmCham EU facilitates the resolution of transatlantic issues that impact business and plays a role in creating better understanding of EU and

² This could potentially affect all non-financial benchmarks, as key contributors are often not able to separate front and back office functions. This includes: airlines, refining companies, small importers, petrochemical companies, power stations, shipping companies and shipping brokers, and even large oil majors.

US positions on business matters. Aggregate US investment in Europe totalled €1.9 trillion in 2012 and directly supports more than 4.2 million jobs in Europe.

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