# PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT AND THE COUNCIL ON BENCHMARKS

## A response by the Futures and Options Association (FOA)

**31st January2014**

**Proposal for a Regulation of the European Parliament and the Council on Benchmarks**

## 1 Introduction

1.1 This response is submitted on behalf of the Futures and Options Association (**FOA**), which is the principal European industry association for 170 firms and organisations engaged in the carrying on of business in futures, options and other derivatives. Its international membership includes banks, financial institutions, brokers, commodity trade houses, energy and power market participants, exchanges, clearing houses, IT providers, lawyers, accountants and consultants (see Appendix 1).

1.2 The FOA notes and supports the following statements by the European Commission in setting the context of the proposed Regulation, namely that:

(a) "*The integrity of benchmarks is critical to the pricing of many financial instruments….*" (Page 2);

(b) the price or other measure of the underlying must be *"reliable and publically available*" if a regulated market is to be capable of being traded in a *"fair, orderly and efficient manner"* (as required by the Markets in Financial Instruments Directive) (para 1,2, page 3).

(c) an EU Regulation on benchmarks will "*help enhance the single market by creating a common framework for reliable and correctly used benchmarks across different member states"*, (para 3.2, page 5), but that it will also look to "*tailor its requirements to sectors and the different types of benchmarks such as commodities, inter-bank interest rate and benchmarks using exchange data*" (para 3.2, page 6) taking into account:

(i) the need to differentiate between:

- those benchmarks which need to be regulated and those which do not need to be regulated, reflecting the observation made in Amendment 6 of the Rapporteur's draft report which stated that "*criteria should therefore be established to determine when an administrator should be subject to regulation"* and, in Amendment 8, that one of the critical determines of the scope of the regulation should be "*the volumetric or sectorial importance of the benchmark"*;

- those benchmark administrators, particularly exchanges and multi-lateral trading facilities, which are already regulated and those which are not already regulated, providing the relevant regulatory requirements cover governance, the management of conflicts of interest, market integrity, price formation, market behaviours i.e. any duplicative regulatory requirements in the Regulation should be disapplied where relevant;

- benchmarks which are "*critical"* and those which are not (taking into account the fact that benchmarks may not become "*critical*" in practice until sometime after they have been established);

- those benchmarks which are regarded as pan-EU or international and those which are strictly national (albeit subject to a harmonised approach where they are "lookalike" benchmarks); and

- financial and other types of benchmarks, particularly those based on commodity trade prices[1] (see also para 2.1 below).

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[1] The FOA notes the observation in Footnote 9 in OFGEM's consultation '*Pricing Benchmarks in Gas and Electricity Markets – A Call for Evidence'* in which it is states that "*in considering the relationship of these issues to the LIBOR investigation, we concluded that although there might be some potential similarities, the risk to*

(ii) benchmark administrators as for-profit competitive organisations are strongly incentivised by the need to produce accurate and credible pricing benchmarks in order to satisfy the users of those benchmarks;

(iii) the fact that a benchmark price is not the result of an exact, academic or mathematical science, but rather the "best evidenced" price which, as such, should be based on authentic price transactions or other price information and aggregated by robust, but individually developed, methodologies;

(iv) the risk that some of the more specialist benchmarks could be economically priced out of the market;

(v) the need for national competent authorities to issue regulatory waivers, where justified, taking into account the thousands of benchmarks that may fall into the current definition, but recognising that the issuance of waivers will have to be on a broadly harmonised basis across member states;

(vi) the nature of the benchmark's user base when determining the burden and nature of the standards i.e. professional or retail;

(d) the enlarged scope of the proposal for a Market Abuse Regulation is to make any manipulation of markets *"clearly and unequivocally illegal and subject to administrative or criminal sanctions"* (para 1.2, page 3);

(e) that, subject to justified need for the regulation to apply to a particular benchmark (see para 1.2 (c)(i)) and to the need for regulatory proportionality, an authorisation requirement will be "*imposed on all benchmark administrators as supervision is the most effective way to ensure the integrity of benchmarks*" (para 3.4.1, page 7).

1.3 The need for the requirements to be tailored in a meaningful and relevant way (see para 1.2(c) above) is particularly important in the case of commodity price benchmarks, bearing in mind:

(a) the reality, complexities and differentiation between classes – and within classes – of commodity markets;

(b) differences in individually determined price assessment methodologies;

(c) the impact on price generated by constraints, limitations and failures in diverse commodity processing, transportation and warehousing infrastructures; and

(d) many commodities are produced in countries which are politically unstable and/or subject to severe weather conditions.

1.4 The FOA believes that the objectives of the proposed Regulation should be closely aligned, where relevant and achievable, with the IOSCO Principles, which focus on the following factors:

(a) *governance*, including the responsibilities and duties of administrators and third parties, particularly in relation to conflicts of interest management and control frameworks;

(b) *benchmark quality,* including benchmark design and integrity, the process of determination and the sufficiency and integrity of transaction and non-transactional data;

(c) *benchmark methodology,* including its transparency, the quality of the process, the effectiveness of internal controls, the management of change and the development of a code of conduct for those submitting data (see also para 1.6 below); and

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*energy markets is lower due to fundamental differences between the two benchmarking processes. The LIBOR rate is based on contributions from market participants; PRAs, unlike Thomson Reuters who formulates LIBOR, has discretion to disregard unreliable data; and there are multiple PRAs operating in energy markets*."

(d) *accountability*, including complaints and consultation processes, documentation requirements, audits and cooperation arrangements with regulatory authorities.

1.5 In addition, the approach to oil price reporting agencies should be aligned with the Principles for Oil Price Reporting Agencies (which were developed by IOSCO, the IEA, the IEF and OPEC and adopted by IOSCO in October 2012) and which IOSCO has extended to all benchmarks published by PRAs; and avoid conflict or unnecessary duplication with either the Regulation on Energy Market Integrity and Transparency (REMIT) provisions (which prohibit the deliberate provision of false information relating to price)) or the proposed benchmark manipulation provisions of the Market Abuse Regulation. In this context, the FOA notesthat there is a public policy recognition that the Principles for Oil Price Reporting Agencies and the associated Code of Conduct could be extended to cover all commodities.

NB. The FOA anticipates that the Commission, in considering the position of PRA benchmarks, will have taken into account that the allegations in relation to those benchmarks are, at this stage, no more than allegations and that they relate not to PRA administrators but to the behaviour of third parties. This is particularly important because PRA administrators have a generally good record in terms of managing and administrating their benchmarks. We note that the main PRAs have recently successfully completed audits of compliance against the PRA Principles by external firms of auditors We also note that Ofgem and the FCA have now closed the inquiry relating to ICIS and have concluded that no evidence of alleged market manipulation could be found and that the interests of consumers have not been harmed.

1.6 The FOA is strongly supportive of reliance being placed on the use of industry Codes of Conduct, particularly in the context of Price Reporting Agencies, providing that they are consistent with IOSCO's approach, approved by the relevant supervisory authority and subject to regular monitoring to ensure compliance. Existing powers of national competent authorities include the ability to prohibit listing for trading or clearing of commodity derivatives contracts where the reference benchmark does not meet the requirements of the PRA Principles. IOSCO's PRA Principles encourage competent authorities to exercise these powers. The PRA Principles also require compliance against the PRA Principles to be subject to external audit.

NB. The FOA would take this opportunity of pointing out that many key benchmark data providers are located outside the EU and, in the case of commodity data provision, are often located in politically sensitive jurisdictions (e.g. Libya, Iraq, etc.) or countries where the data providers are state-owned enterprises. This means that there may be significant reluctance to enter into legally-binding foreign codes of conduct which may require major IT and systems and controls changes. Instead, they are more likely to cease from making price data submissions. As the Commission will appreciate, this possible outcome will be exacerbated where they are providing data to more than one PRA since this will multiply the administrative burden. This concern is, in part, reflected in Recital 13.

1.7 The FOA would emphasise that standards set for benchmark administrators and price contributors – whether in the final Regulation or in any supporting code of conduct – should be necessary, proportionate and deliverable[2]. More particularly, they should:

(a) avoid the imposition of excessively costly standards

(i) which are likely to be yet another "pass through" cost for the corporate and institutional end-users; and

(ii) which could disincentivise data contributors and/or benchmark administrators (see para 2.3 below), particularly data contributors located outside the EU;

[2] In its consultation paper '*Pricing Benchmarks in Gas and Electricity Markets – A Call for Evidence"* (6/13), OFGEM emphasised in paras 3.5 and 3.6 that any forward measures "*should be targeted towards any specific problem identified and would need to be thoroughly assessed to ensure that they are effective and proportionate*"; but they were mindful of the risk of unintended consequences and they expected to "*work with stakeholders to identify and mitigate these*"; and that the outcome of hearing the views and evidence of stakeholders may mean "*that it is not appropriate for OFGEM to take any action in this area*".

(iii) which could result in the abandonment of some of the smaller or more specialist benchmarks on the grounds of cost (cf also the note to para 1.6 above) some of which are critical to the management of the market risk of specialist users;

(b) avoid any form of dual regulation in the case of, for example, exchange or other regulated market infrastructures or regulated benchmark administrators or price submitters where their conduct is already the subject of rules.;

(c) be reviewed regularly to ensure that the obligations placed upon benchmark administrators and price contributors are and continue to be realistically attainable and do not impose any form of absolute legal liability e.g. they should include, where appropriate and relevant in the standards, words such as "*all reasonable steps*" or "*where practical*" or "*designed to ensure*" rather than the absolute standard of "*ensure*".

(d) take into meaningful account the fact that market development, innovation and feedback from the users of benchmarks will drive their own processes of change and that they will have to be incorporated in the standards promptly;

(e) particularly in the context of Price Reporting Agencies, be fully consistent with IOSCO's approach (and it is noted that administrators will be required to draw up contributor codes of conduct outlining the responsibilities and duties of contributors and we would point to IOSCO's warning in the PRA Principles, and from Ofgem the UK energy regulator, of the risks that imposing administrative burdens on voluntary contributors in commodity markets may lead to a reduction in contributions); and should avoid any unjustifiable, super-equivalent "add ons" to that approach; and

(f) recognise the need for operational flexibility at times of market stress.

1.8 The FOA appreciates the recognition given to the role of non-transactional price data and would emphasise that it is particularly important in the case of not just illiquid markets, but illiquid long-dated contracts in liquid markets. In this context, it is noted that Recital 23 states that "*other data may be used in those cases where the transaction data is insufficient to ensure the integrity and accuracy of the benchmark".*

1.9 The description and scope of the proposed Regulation, in section 3.4.1, is described as covering published benchmarks used to reference a financial instrument listed or traded on a regulated venue or a financial contract (such as a mortgage etc).

However, there is a need for significantly greater clarity on the question of scope:

(a) as regarding the position of exchanges and other market infrastructures with regard to the definition of benchmarks and benchmark administration;

(b) to ensure that it does not include minor benchmarks or internal reference price indices which are designed primarily for internal market risk management purposes;

(c) for the avoidance of doubt, to ensure that benchmarks which are not based on market prices (e.g. economic indices) are outside the scope of the Regulations; and

(d) because the description in section 3.4.1 does not quite equate with the description of scope in Article 2, which, taken together with the definition of "benchmark" in Article 3.1(11) does not appear to restrict the definition in this way.

1.10 The description in para 3.4.2 which refers to ensuring the avoidance of conflicts of interest does not equate with other areas of the regulation which refers to systems and controls which are intended to manage rather than avoid the existence of conflicts of interest. [3]

[3] IOSCO is more generic in terms of protecting the integrity and independence of benchmark determination from undue conflicts of interest insofar as it states in Principle 3 (on page 16) of its Principles for Financial Benchmarks:

The FOA recognises that the management of conflicts of interest, where they exist, is critical to the integrity of a benchmark. However, it would emphasise, contrary to the assumptions made in Recital 12 that "*all benchmark administrators are potentially subject to conflicts of interest*" and Recital 17 that "…*most administrators are subject to some conflicts of interest…,"* the fact is that, while it is recognised that the management of conflicts of interest, where they exist, is critical to the integrity of a benchmark, better recognition should be given to the fact that some benchmark administrators such as PRAs do not face inherent conflicts of interest e.g. they have "no skin in the game" as to whether or not market prices rise or fall and their remuneration is sourced from licensing fees and not on the basis of "issuer pays" which was such an issue with CRAs.

1.11 The FOA agrees generally with the three overarching requirements/objectives set out in para 3.4.3 with regard to input data and methodology, but the first of those indents should be cast as a "best endeavours" requirement rather than an absolute requirement which simply may not be achievable, particularly if certain price submitters elect to withdraw on grounds of cost, legal risk, etc.

1.12 With regard to Articles 4.2, 5.2, 7.2, 11.2 and 4, 15.2 and 16.2, and the supporting annexes, the FOA would urge the EU Commission to review carefully the detail and standards set out in the Annexes for the purpose of avoiding excessive granularity or undue harmonisation which could impair the need for differentiation and the risk of excessive cost and undue legal risk.

1.13 The FOA has attached at Appendix 2 a copy of a set of draft guidelines "*Price Indices: Guidelines for Price Aggregators and Data Providers*", which was drafted by the FOA, but never finalised. Nevertheless, some of the proposed standards and approaches may be useful in providing additional input to Commission thinking on this issue.

## 2 FOA Comment on the Recitals

2.1 With regard to the need for proportionality, the FOA welcomes the recognition in Recital 9 that "*the framework should… provide for a proportionate response to the risks that different benchmarks pose*" and in Recital 29 that "*Different types of benchmark and benchmark sectors have different characteristics, vulnerabilities and risks*".

2.2 With regard to Recital 12, for the reasons already given in 1.10 above, the FOA does not accept that "*all*" benchmark administrators are potentially subject to conflicts of interest or, as stated in Recital 17, "*most administrators are subject to some conflicts of interest*".

2.3 With regard to Recital 13, the FOA notes the recognition that contributing to a benchmark is "*a voluntary activity*" and that "*if any initiative requires contributors to significantly change their business models, they may cease to contribute*". This recognition is a key factor in determining the cost and legal consequences of introducing regulatory change for contributors.

2.4 With regard to Recital 21, the FOA does not believe it should be presumed that a benchmark administrator is *"able to evaluate the integrity and accuracy of this input data on a consistent basis*". It is, in the view of the FOA, the responsibility and function of the price contributor to undertake this task and the role of the benchmark administrator is to be satisfied that the contributor's systems and controls are appropriately designed to ensure that the data provided to the administrator is authentic, accurate and relevant.

2.5 With regard to Recital 25, the FOA would observe that, while the need for consultation is essential when it is proposed to change the benchmark methodology, it is equally important that the responses to that consultation are given meaningful consideration and that an appropriate notice period is given for any proposed change.

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Final Report" (July 2013) "*To protect the integrity and independence of Benchmark determination, Administrators should document, implement and enforce policies and procedures for the identification, disclosure, management, mitigation ………of conflicts of interest* i.e. the Commission should not seek to prioritise "avoidance" over "management" or "mitigation".

2.6 With regard to Recital 31, the FOA notes the observation that it may be necessary for a competent authority to mandate the provision of prices in the case of key benchmarks, but:

(a) would caution the Commission not to undermine the recognition that is afforded to the voluntary nature of the provision of transactional and other price data as recognised in Recital 13;

(b) does not believe it is appropriate for the European Commission to seek to undermine the economic right of self-determination of firms in deciding, in a commercial environment, what services they can afford to deliver and what services they cannot afford to deliver;.

(c) would stress that, notwithstanding para 2.3(a), if such contributions are to be mandated in the case of key benchmarks, a high standard of due diligence is essential to ensure that the consequential cost burden and legal risk accruing to contributors is proportionate and fair.

2.7 With regard to Recital 32 the FOA believes that it is important for users of benchmarks to understand not just the benchmark measures or the vulnerabilities of a benchmark, but also the methodology for calculating the benchmark and the basic standards of governance observed in the process. This is not to say, however, that disclosure needs to go into a level of detail that is, firstly, burdensome, secondly, requires excessive updating and thirdly, may actually deter the information from being read because it is too extensive and too detailed. At the same time, it should be open to any user of benchmarks to seek more information and for the Administrator to provide it, subject to competition or confidentiality issues for the Administrator.

The FOA would stress the importance of mandated disclosure not over-riding the need to preserve the intellectual property rights of benchmark administrators.

2.8 The FOA agrees with Recital 34 that EU benchmarks and how they are regulated and supervised should be closely aligned to the IOSCO Principles, but:

(a) the observation that the regulation should "take into account" those Principles is simply not strong enough and very much leaves the Commission with a wide discretion to adopt super-equivalent standards to those Principles;

(b) excessive granularity in terms of the requirements should be avoided in order to allow market-driven changes to be introduced promptly into applicable standards and requirements – hence the importance of codes of conduct;

(c) there should be a reference to the applicability of PRA principles to all benchmarks produced by the PRAs.

2.9 With regard to Recitals 37, 38, 41 and 42, the FOA welcomes the acknowledgement of the importance of compliance with national laws, rights of defence and the other fundamental rights, including the right to privacy; and that member states should not seek to exercise unduly intrusive powers other than where it is essential for the proper investigation of breaches in compliance and where there are no other mechanisms available to them. The FOA would emphasise that these concerns are heightened by the fact that some competent authorities have statutory immunity which deprives a regulated entity from being able to exercise the same civil rights of redress as is generally made available to natural and legal persons and therefore constraints on the exercise of unduly wide powers becomes even more important than is envisaged in this Recital.

2.10 With regard to Recital 44, the FOA would repeat its view that the concept of a sanction being both "*proportionate and dissuasive*" is illogical. While some proportionate sanctions may still have a dissuasive effect, generally they can only be properly and effectively dissuasive where they are disproportionate to the nature of the offence!

## 3 FOA Comment on the Articles

3.1 The FOA supports the general objectives behind the introduction of the Regulation as set out in Article 1, but would reiterate its earlier observations to avoid undue granularity and mandated harmonisation which will impair the ability to introduce fast-track operational and market-driven changes as well as changes made in response to user comments or as a result of consultations regarding key changes to benchmark methodologies, etc.

3.2 With regard to the issue of scope and Articles 2 and 3.1(ii), the FOA would repeat its concerns over the question of scope raised in para 1.9 in this response, but, at the same time, would repeat its support of the overall objective of the governance requirements.

Article 4.1(b) refers to the "*avoidance of conflicts of interest*" but, as the rest of (b) is more about ensuring that the provision of a benchmark is "*not affected by any potential conflicts of interest*", the primacy given to avoidance over management of conflicts of interest appears, at least in its title, to be out of step with the rest of the Regulation.

As a related matter, the FOA would express concern over the presumption of conflicts of interests arising in connection with the flow of information between a benchmark administrator and the front office of a price submitter insofar as a key element of corroborative due diligence is ensured precisely through this level of communication i.e. the issue continues to be about the management of conflicts of interest rather than their avoidance.

3.3 With regard to Article 5, so far as Articles 4.2 and 4.3 are concerned, the FOA would urge any further requirements imposed by the Commission to be proportionate and sensitive to cost implications and to avoid conflict or overlap with related regulations and directives and the IOSCO Principles.

3.4 With regard to Article 7.1(c), the FOA believes that there may be some smaller, more specialist types of benchmarks where sources of data may well represent more than 50% of the volume used to determine prices. At the same time, the FOA recognises that large scale contributions of this nature will require additional on-going oversight and may trigger further enquiry to establish their legitimacy.

3.5 With regard to Article 7.2, the FOA believes it is both unrealistic and unreasonable to expect administrators to have the degree of insight (which would have to be on a continuous basis) into the internal workings and operations of a contributor sufficient to be able to *"identify breaches of [Market Abuse Regulation] and any conduct that may involve manipulation or attempted manipulation of the benchmark".* Clearly, some essential elements of misconduct may only be known to or discoverable by the contributor and not the administrator. Aside from this point, the FOA recognises the importance of appropriate due diligence being exercised by administrators in this area and of notifying the regulatory and competent authority where relevant information comes to the attention of an administrator.

3.6 With regard to Article 8, the FOA would repeat its observation that this is an area where a clear division of responsibility should be apportioned between the contributor of data and the administrator and therefore questions the generality of the obligation placed upon the administrator about ensuring that there are "*adequate systems and effective controls to ensure the integrity and reliability of the input data*".

More particularly, the FOA believes that Article 8.1 and 8.2 could be more reasonably redrafted to avoid any form of absolute requirement which goes beyond an "*all reasonable steps*" test:

> Para 8.1 – *"The administrator shall ensure that there are adequate systems and effective controls in place designed to ensure the integrity of input data for the purpose of paragraph 2*",
>
> Para 8.2 – "*The administrator shall take all reasonable steps to monitor the input data in order to identify breaches of the [ Market Abuse Regulation ] and any conduct that may*

*involve manipulation or attempted manipulation of the benchmark and shall notify the relevant competent authority…..*"

The FOA would also suggest that it is more a question of systems and controls being "*designed to ensure*" rather than the more absolute guarantee test of "to ensure". This is relevant in terms of legal liability.

3.7 With regard to Article 9 (and Section D of Annex 1), the FOA would reiterate earlier observations made in this response about how important it is that standards set for benchmark administrators and price contributors are "*reasonable*" and proportionate for reasons already given and which appears to be recognised in the introduction to the proposed Regulation, its Recitals and Articles.

3.8 With regard to Article 11.1(b), the FOA believes:

(a) the word "*ensure*" should be replaced by the words "*designed to ensure*"; and

(b) there needs to be a clear delineation of responsibility in terms of the controls that are required to be in place by an authorised contributor and those that are required to be put in place by an administrator.

This draft Article runs the risk of imposing an unrealistic burden on administrators.

3.9 The requirement placed upon the Commission to adopt a list of benchmarks should be supplemented by an obligation to review the list for the purposes of determining the extent to which other benchmarks may become critical and those on the list may decline to the point where they are no longer critical i.e. "*The Commission shall adopt and keep under review a list of benchmarks….*"

3.10 With regard to Article 14, while the FOA notes that the power to mandate price contributions are subject to a threshold and restricted to supervised entities and critical benchmarks, authorised entities should not be required to provide input data if it imposes unrealistic and/or unacceptable burdens on contributors and high levels of legal risk. Further, to the extent that competent authorities will retain the power to mandate contributions, there is a consequential due diligence obligation on the part of those authorities to ensure that both the cost of making those contributions and any consequential legal risk are realistic and therefore the mandate can be properly and fairly exercised in a way that takes account of the financial consequences for a mandated contributor. Put another way, the reporting of trades should be encouraged and not disincentivised by burdensome obligations and high cost.

3.11 With regard to Article 15, while the FOA supports the general objectives and content of the benchmark statement, it would reiterate its concerns that they should not be so granular as to impose excessive updating obligations on an administrator or so excessive as to disincentivise users from actually reading the benchmark statement – a problem which exists in the context of other disclosure obligations that are imposed upon regulated firms. In other words, it should be set at a sufficiently high level to avoid becoming unduly onerous for administrators, but at a meaningful level so as to be fit for purpose.

It should be borne in mind that, for example, in the context of the obligation to identify "*technical specifications*", it is important:

(a) to avoid undue clutter in benchmark statements and rely on the fact that it is open to any user, on its own initiative, to contact the administrator for that kind of detail (and the requirement to respond to any such request could be stated in a benchmark statement); or

(b) that, as already stated in this response, the need to preserve commercial confidentiality and to respect fully the intellectual property rights of benchmark administrators is not overrided by the requirement to disclose key elements of technical detail.

3.12 With regard to Article 16, it is presumed that the publication of input data will be done in such a way as to preserve the trading confidentiality of a contributor. I Individual contributors would be deterred from price reporting if there was any risk that the data provided by them would be published in such a way that the contributor is capable of being identified by implication or otherwise.

3.13 With regard to Article 18.2, it is presumed that, once the supervised entity has warned a consumer that a benchmark is not suitable for that consumer, it is then a matter for the consumer as to whether or not they take a different view and still wish to enter into a financial contract with the supervised entity.

The FOA questions whether the standard of suitability is unreasonably high or even appropriate but, in any event, for the purpose of clarity, believes that Article 18.1 should end with the words "*… referencing the financial contract to that benchmark is suitable for him based on the information provided by that consumer*."

3.14 With regard to Title V, the FOA would emphasise the importance of non-EU benchmarks in the EU and the significant reliance placed upon them in managing the market risk and the valuation of thousands of portfolios and individual investments and risk management positions across the whole spectrum of market participation. This means that, in the view of the FOA, the policy approach of the EU Commission should be, wherever possible, to recognise a non-EU benchmark to avoid the costly and complex process of their re-evaluation.

3.15 While the FOA does have some concerns over the basis for recognising non-EU benchmarks, it very much notes and supports the fact that there are no reciprocity conditions attached to recognition.

With regard to Article 20, the FOA very much supports the view expressed in this Article that benchmarks will be "recognised" in the EU for use by authorised entities in the EU if they are regulated and supervised in compliance with the IOSCO Principles (although it is noted this is dependent on the duty of IOSCO to confirm the adequacy of the requirements). The FOA would, however, suggest that it may be appropriate to delete the words "in accordance with national legislation" insofar as some competent authorities may simply look to incorporate the Principles directly within their own rules without the need for any change to national legislation or, if they do adopt national legislation, it may not be in a structure or with provisions that are equivalent to those set out in the proposed EU Regulation. The FOA notes that the draft report of the Rapporteur emphasises that "*it is important that such international trade is not disrupted by the inappropriate application of regulation."* (Amendment 17). ?? In this context, the FOA prefers the approach set out by the Rapporteur in the proposed amendments 80 in her Report.

Finally, the FOA would emphasise that, in its view:

(a) it is critically important that there are transitional "business continuity" provisions sufficient to facilitate the continued use of benchmarks through the process of recognition – an industry concern that has been reflected on many occasions in relation to previous EU "recognition" issues;

(b) the EU should not seek to impose additional burdens or obligations as a condition for recognition if they go beyond or are super-equivalent to the IOSCO Principles;

(c) unauthorised entities in the EU should be able to use any non-EU benchmark as a reference point at their own discretion on an own initiative basis where they are readily able to access those benchmarks;

(d) the measure of non-EU benchmark recognition should be based on comparability rather than any strict equivalence standard, insofar as there will be different interpretations of the IOSCO Principles and different provisions covering, for example, the prevention of market abuse/manipulation of benchmarks;

(e) the Commission should avoid setting any unduly high standards for EU benchmark administrators and contributors which could undermine its discretion and ability to adopt pragmatic approach towards comparability/equivalence in terms of recognising non-EU benchmarks i.e. it should be careful not to fetter its own discretion in this area.

3.16 Further, the FOA would, however, urge the EU to adopt a broad comparability test rather than a strict equivalence test insofar as it is inevitable that there will be different interpretations of the IOSCO Principles and there may be different provisions governing, for example, preventing of market abuse/manipulation of benchmarks.

3.17 The FOA would note that, while third country administrators may be subject to comparable authorisation or registration requirements and subject to effective supervision and enforcement, the governing rules may not themselves be precisely equivalent to those set out in the proposed regulation. On that basis, the FOA believes that the standards set for equivalence/recognition may be too high and potentially obstructive to the use of non-EU benchmarks. This is another reason why the standards set in the proposed regulation should not be so high or superequivalent to the IOSCO Principles as to undermine the ability of the Commission to adopt a pragmatic approach towards equivalence in terms of it being based on comparability.

3.18 With regard to Article 21.2(a), the FOA believes that the test for determining whether or not to withdraw the registration of an administrator should read "…*that the administrator is acting in a manner which is clearly and seriously prejudicial to the interests of users*…"

3.19 With regard to Article 24.1, the FOA believes that the competent authority should have some discretion as to whether or not to withdraw or suspend the authorisation of an administrator insofar as, for example, there may be very sound reasons as to why benchmarks have not been provided or the conditions breached or a false statement made or the infractions may be of a very minor nature. On this basis, the FOA believes that the wording should be revised to read *"…the competent authority shall have the power to withdraw of suspend the authorisation of an administrator…"*

3.20 With regard to Articles 27 and 28, the FOA believes that, in each case, the requesting host-state authority should be required to give a written statement of reasons to the relevant home-state competent authority if it wishes to obtain information or carry out an on-site inspection or investigation in a foreign jurisdiction. It is not clear why Article 27 is restricted to disclosing information only to other member states as opposed to competent authorities generally, particularly since disclosure of information is a key condition of regulatory recognition of benchmarks.

3.21 The FOA believes that the provision in Article 30.1(e) which requires a competent authority to obtain any necessary prior judicial authorisation before entering premises, should actually apply to any of the actions set out in Article 30.1 and not just to Article 30.1(e). For this reason, the FOA believes that the sentence in Article 30.1(e) "*where prior authorisation is needed from the judicial authority… prior authorisation;*" should appear as a concluding paragraph to all the sub-indents in Article 30.1.

3.22 Further, the concluding para to Article 30.2, in the view of the FOA, should refer specifically to rights of privacy and be amended to read …"*with regard to the right of defence, right of privacy and other fundamental rights*."

The FOA would emphasise that, in any circumstances where a competent authority is making any fast-track interim decisions in order to prevent significant or imminent damage to the financial system, it is important that any such decisions are:

(a) founded on strong and irrefutable evidence; and

(b) give full recognition to these rights in the process, including insuring that the basic defence of any persons who are to be the subject of a fast-track decision are known to the competent authority prior to making that decision i.e. any such decision is made on a fully-informed basis.

3.23 With regard to Article 31.4, the FOA presumes that private censures or warnings, even though specifically not provided for in Article 31.2, will be permitted to be issued by competent authorities on the basis that the obligations in Article 31.4 are not exclusive. While the use of the words "at least" does suggest that anything less than the identified measures and sanctions may not be acceptable, this does appear to be overridden by this sub- Article which empowers member states to allow competent authorities to have "other sanctioning powers".

3.24 With regard to Article 32, , the FOA believes that other factors that will need to be taken into account in determining the nature and seriousness of the infringement could include, for example, any mitigating steps that have been taken by the party or where the infringement was self-reported. In other words, the criteria should not be written in terms of being exclusive, but rather indicative of the kind of factors that can be taken into account.

3.25 In general terms, the FOA is concerned that the proposed fining regime undermines and curbs the capability of ESMA's board of supervisors to properly take into account any mitigating factor and does not draw sufficient distinction between misbehaviours which are deliberate and those which are negligent. The FOA believes that a fair judicial outcome is very much dependent upon sufficient discretion being given to an adjudicator to reach a proportionate decision in terms of sanctioning.

It is unclear as to why provisions governing hearings, fines and procedures relevant to infringements are included in this directive rather than in the Market Abuse Regulation and then reflected in this Regulation by way of a cross-reference.

3.26 The FOA supports the fact that national competent authorities will be responsible for benchmark supervision, including critical benchmarks and, in the latter case that will involve the use of regulatory colleges. However, the FOA believes that college membership should be restricted to competent authorities from jurisdictions in which the role played by the relevant benchmark is critically important. It supports therefore the terminology covering eligibility to be a member of a college in Article 34.3, but believes that the same test of significance should apply to the competent authorities of contributors insofar as there may be many contributors to a benchmark, some of which may be making only a minor contribution. No doubt, the authorities could be kept informed, etc. through existing memoranda of understanding rather than being involved directly in a regulatory college.

## 4 FOA Comment on the Annexes

4.1 The FOA does not seek to replicate all the observations that have been made by individual respondents to the detail set out in the Annexes. However, they do appear to be, in general terms overly granular, expensive and burdensome and do carry high levels of legal risk for administrators and contributors.

Better account should be taken of the fact that, firstly, it will be in the interests of administrators to ensure that a benchmark is credible, reliable, accurate and relevant; secondly, misbehaviour in the setting of benchmarks and the provision of price data will be covered by tough new controls set out in the market abuse framework; and thirdly, fast track changes cannot be achieved if too much detail is set in the Regulation. The FOA believes that the Regulation should be set at a reasonably high level leaving the detailed standards to be included in, where applicable, Codes of Conduct (which will be overseen, where appropriate by regulatory authorities); and the question of manipulation to be addressed in the proposed Market Abuse Regulation.

It remains critically important that the requirements set out in the Annexes are proportionate to the size, complexity and systemic importance of the administrators' benchmark operations and are resource sensitive, particularly in the context of small or specialist benchmarks.

4.2 With regard to para 1 in Annex 1 Section A, the FOA questions whether operational and functional separation should be presumed to be the only means of managing conflicts of interest or that there is a fundamental conflict with regard to submission of price data by the front office which cannot be managed or supervised effectively. The fact is that corroboration of data is

essential and it is often only available from the front offices of banks and other financial intermediaries.

4.3 In relation to para 2, the FOA believes that the word "*potential*" could be more fairly changed to read "*reasonably foreseeable*".

The FOA does not believe that disclosure should be mandated in the case of conflicts of interest which are fully and effectively managed so as not to impact adversely on the credibility of a benchmark. This could imply that the benchmark is lacking in integrity. In general regulatory terms, disclosure is only usually required in relation to those conflicts of interest that cannot be managed and where the disclosure is material in terms of enabling informed decisions to be made.

4.4 In relation to Para 3, the FOA believes that the sub-paras of (a) and (b) would read better if (a) commences with the word "*ensure…*" and para (b) deletes the word "*shall*".

4.5 With regard to para 4(b), the FOA assumes that this requirement applies to areas of undue influence or conflicts of interest that are not capable of being properly managed and, if that is the case, this should be stated specifically in para 4(b).

4.6 With regard to para 10 , the FOA would reiterate its earlier observations about the importance of the steps being required to be taken by a benchmark administrator being proportionate and deliverable as well as recognising the distinctive responsibilities between benchmark administrators and price contributors in terms of oversight and verification of data.

4.7 The FOA believes there is an inherent problem insofar as, on the one hand, the board or committee with responsibility for undertaking the oversight function is required to be independent of conflicts of interest, yet where the administrator is owned or controlled by contributors or users, some of those contributors (which will have conflicts of interest) may be included on the board (albeit that they cannot be in the majority). Exclusion of individuals should not generally be dependent on whether there is a conflict of interest, but rather whether the relevant conflicts of interest cannot be properly and effectively managed.

With regard to para 16, the FOA would urge the Commission to take significant account of the substantial cost in retaining an independent external auditor to review and report on critical benchmarks and, while it welcomes the fact that this obligation will apply only to those benchmarks which can be deemed to be of systemic importance, the cost of the administrators of critical benchmarks is likely to be significant for all administrators[4].

The FOA believes that this cost can be mitigated by allowing the supplementary use of an internal independent auditing process.

[4] IOSCO states that "*The frequency of audits should be proportionate to the size and complexity of the administrator's operations and the breadth and depth of Benchmark use by Stakeholders*" (P. 173 "Principles for Financial Benchmarks; Final Report" July 2013). Further, the second paragraph states that the appointment of an independent external auditor to periodically review and report on an administrator's methodology must be "*appropriate to the level of existing or potential conflicts of interest identified by the Administrator (except Benchmarks that otherwise regulate or are supervised by a national authority other than a relevant regulatory authority*".

**APPENDIX ONE**

LIST OF MEMBERS OF THE FOA

**APPENDIX TWO**

DRAFT GUIDELINES