

Indices used as benchmarks in financial instruments and financial contracts

2013/0314(COD) - 18/09/2013 - Legislative proposal

PURPOSE: to establish a regulatory framework at Union level for indices used as benchmarks in financial instruments and financial contracts whilst ensuring a high level of consumer and investor protection.

PROPOSED ACT: Regulation of the European Parliament and of the Council.

ROLE OF THE EUROPEAN PARLIAMENT: the European Parliament decides in accordance with the ordinary legislative procedure and on an equal footing with the Council.

BACKGROUND: the pricing of many financial instruments and financial contracts - such as interest rate swaps, and commercial and non-commercial contracts, such as mortgages - depends on the accuracy and integrity of benchmarks. An index is calculated using a formula or some other methodology on the basis of underlying values. When an index is used as a reference price for a financial instrument or contract it becomes a benchmark. Therefore, it is important to target all benchmarks that price a financial instrument or consumer contract or that measure the performance of investment funds.

Cases of manipulation of interest rate benchmarks such as LIBOR (London Interbank Offered Rate) and EURIBOR (Euro Interbank Offered Rate), as well as allegations that energy, oil and foreign exchange benchmarks have been manipulated, have demonstrated that benchmarks whose setting processes share certain characteristics, such as being subject to conflicts of interest, the use of discretion and weak governance, may be **vulnerable to manipulation**.

Failures in, or doubts about, the accuracy and integrity of indices used as benchmarks may undermine market confidence, cause losses to consumers and investors and distort the real economy. It is therefore necessary to ensure the **accuracy, robustness and integrity of benchmarks and the benchmark setting process**.

In most Member States there is currently no regulation at national level on the production of benchmarks. The International Organisation Securities Commissions (IOSCO) recently agreed principles on benchmarks which are to be implemented by its members. However these principles provide flexibility as to the scope and means of their implementation and in relation to certain terms. An **EU initiative** will help enhance the single market by creating a common framework for reliable and correctly used benchmarks across different Member States.

This proposal supplements the [proposed Regulation](#) on Market Abuse (MAR) and the [proposed Directive](#) for a Criminal Sanctions for Market Abuse (CSMAD) (MAR has been the subject of a political agreement by the European Parliament and the Council in June 2013) clarify that any **manipulation of benchmarks is clearly and unequivocally illegal** and subject to administrative or criminal sanctions.

IMPACT ASSESSMENT: the Commission conducted an impact assessment of policy alternatives. The policy options encompassed options to: (i) limit incentives for manipulation, (ii) minimise discretion and ensure benchmarks are based on sufficient, reliable and representative data, (iii) ensure internal governance and controls address risks, (iv) ensure effective supervision of benchmarks and, (v) enhance transparency and investor protection.

LEGAL BASIS: Article 114 of the Treaty on the Functioning of the European Union.

CONTENT: the proposed Regulation seeks to **introduce a common framework** to ensure the **accuracy and integrity** of indices used as benchmarks in financial instruments and financial contracts in the Union.

The proposal has **four main objectives** that aim to improve the framework under which benchmarks are provided, contributed to and used:

1. **to improve the governance and controls over the benchmark process** and in particular ensure that administrators avoid conflicts of interest, or at least manage them adequately;
2. **to improve the quality of the input data and methodologies used by benchmark administrators** and in particular ensure that sufficient and accurate data is used in the determination of benchmarks. The administrator shall obtain the input data from a reliable and representative panel or sample of contributors so as to ensure that the resultant benchmark is reliable and representative of the market or economic reality that the benchmark is intended to measure ('Representative contributors');
3. **to ensure that contributors to benchmarks are subject to adequate controls**, in particular to avoid conflicts of interest and that their contributions to benchmarks are subject to adequate controls. The integrity and accuracy of benchmarks depends on the integrity and accuracy of the input data provided by contributors. It is essential that the obligations of the contributors in respect of this input data are clearly specified, can be relied on and are consistent with the benchmark administrator's controls and methodology. It is therefore necessary that the benchmark administrator produces a **code of conduct** to specify these requirements and that the contributors are bound by that code of conduct;
4. **to ensure adequate protection for consumers and investors using benchmarks** by enhancing transparency, ensuring adequate rights of redress and ensuring suitability is assessed where necessary. In order for users of benchmarks to make appropriate choices of, and understand the risks of, benchmarks, they need to know what the benchmark measures and their vulnerabilities. Therefore the benchmark administrator should publish a **statement** specifying these elements as well as publish the input data used to determine the benchmark.

The proposed Regulation applies to all published benchmarks that are used to reference a financial instrument traded or admitted to trading on a regulated venue, or a financial contract (such as mortgages) and benchmarks that measure the performance of an investment fund. The proposal exempts from its scope central banks that are members of the European System of Central Banks.

BUDGETARY IMPLICATION: the specific budget implications of the proposal relate to task allocated to ESMA. The new tasks will be carried out with the human resources available within the annual budgetary allocation procedure, in the light of budgetary constraints which are applicable to all EU bodies and in line with the financial programming for agencies.

In summary, the main budgetary implications of the proposal are:

DG MARKT staff: 1 AD staff member (full-time): the total estimated costs are € 0.141 M yearly.

ESMA:

- **Staff costs** (two temporary agents): the total yearly costs of these 2 temporary agents would be of €0.326 M, towards which the Commission would contribute 40% (€ 0.130 M) and Member States 60% (€ 0.196 M) yearly.
- **Operational and infrastructure costs:** an initial expense of € 0.25 M is also estimated for ESMA, towards which the Commission would contribute 40% (€ 0.1 M) and Member States 60% (€ 0.15 M) in 2015.

ESMA will also need to produce a report on the application of this Regulation by 1 January 2018 with a total cost of € 0.3 M towards which the Commission would contribute 40% (€ 0.12 M) and Member States 60% (€ 0.18 M) in 2017.

DELEGATED ACTS: the proposal contains provisions empowering the Commission to adopt delegated acts in accordance with Article 290 of the Treaty on the Functioning of the European Union.