III

(Preparatory acts)

EUROPEAN ECONOMIC AND SOCIAL COMMITTEE

495TH PLENARY SESSION OF THE EESC ON 21 AND 22 JANUARY 2014

Opinion of the European Economic and Social Committee on the ‘Proposal for a Regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts’

COM(2013) 641 final — 2013/314 (COD)

(2014/C 177/08)

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On 18 and 10 October 2013 respectively, the Council and the European Parliament decided to consult the European Economic and Social Committee, under Article 114 of the Treaty on the Functioning of the European Union, on the

Proposal for a Regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts


The Section for the Single Market, Production and Consumption, which was responsible for preparing the Committee’s work on the subject, adopted its opinion on 16 December 2013.

At its 495th plenary session, held on 21 and 22 January 2014 (meeting of 21 January), the European Economic and Social Committee adopted the following opinion by 140 votes with 3 abstentions.

1. Conclusions and recommendations

1.1 Financial benchmarks play a fundamental role in the financial sector, both in pricing products and in allocating risk and capital fairly. Benchmarks must be credible and reliable to allow the financial markets to operate efficiently.

1.2 The episodes of benchmark manipulation have sparked global doubt and concern regarding the integrity of benchmarks, undermining the integrity of the system and commercial certainty. The Committee is concerned about the serious consequences of such behaviour. Manipulation can result in major losses for investors, distort the real economy and, more generally, threaten confidence in the markets. The Committee therefore calls for the proposed new measures to be adopted as swiftly as possible.

1.3 In April 2013, the United Kingdom set up the Financial Conduct Authority (FCA), which monitors financial bodies. The FCA regulated LIBOR, establishing new requirements which reinforce governance and oversight and introducing measures sanctioning those responsible for LIBOR manipulation.

1.4 The European Commission, amending the proposals for the Market Abuse Regulation (MAR) and the Criminal Sanctions for Market Abuse Directive (CSMAD), confirmed that any manipulation of financial benchmarks was illegal and laid down administrative or criminal sanctions. However, while penalties are necessary, they are not enough to avert the danger of further manipulation.
1.5 The Committee accordingly welcomes the Commission’s proposal for this regulation. It considers that this proposal has met the objective of improving the legislation which ensures the necessary integrity of the market and of benchmarks, guaranteeing that they are not distorted by any conflict of interest, that they reflect economic reality and that they are used correctly. The grounds of law and order in economic matters are obvious.

1.6 Measures for the protection of whistleblowers are particularly important. The Committee recommends that the rule include a reference to the proposal to amend Directive 2003/6/EC on market abuse, which explicitly requires the Member States to adopt rules providing for the protection of whistleblowers.

1.7 The Committee is pleased to note that the proposal is in line with the principles identified last summer by the International Organisation of Securities Commissions (IOSCO) following many consultations, and thus significantly reduces implementation costs.

1.8 The notorious scandals regarding LIBOR and EURIBOR manipulation, along with subsequent scandals about manipulation of benchmarks for exchange rates and the prices of crude oil, petroleum products and biofuels, demonstrate the need for regulation on a wide range of benchmarks, including those used for energy derivatives and commodities. The Committee agrees without reservation and strongly supports the proposal’s broad scope, which respects the proportionality principle.

1.9 The regulation increases market transparency and adopts measures to reduce fragmentation. Uniform application of legislation avoids the danger (which is considerable in financial markets) of regulatory arbitrage and so end users will have the advantage of uniform cross-border benchmarks.

1.10 The Committee, which has always sought to enhance consumer protection, considers that the regulation is an appropriate addition to current legislation which would otherwise lack any instrument guaranteeing suitable and appropriate evaluation of benchmarks. Investors have the right to know that their securities (loans, derivatives, etc.) are protected from losses caused by market manipulation.

1.11 The Committee reiterates its disappointment at the excessive use of delegated acts which — in this proposal for a regulation as elsewhere — do not seem to be consistent with the Treaties. Many subjects which are included as delegated acts should be defined in the regulation. The Committee has adopted an opinion on this issue (1) and calls on the Commission to keep it informed of any future measures adopted in this field by means of delegated acts.

2. Gist of the proposal for a regulation

2.1 The European Commission has submitted a proposal for a regulation which imposes rules on benchmarks for financial instruments and contracts within the European Union.

2.2 The general objective of the proposal is to ensure the integrity of benchmarks, guaranteeing that they: a) are not distorted by conflicts of interest; b) reflect the economic reality that they are intended to represent and measure; c) are used appropriately.

2.3 The main points of the proposal are summarised below and aim to:

— improve governance of and controls over the benchmark process. Prior authorisation and ongoing supervision of the provision of benchmarks will be required, at national and European level.

The proposal also stipulates that benchmark administrators should avoid conflicts of interest where possible, or at least manage them adequately when they are inevitable;

— improve the quality of the input data and methodologies used by benchmark administrators. The proposal stipulates that when setting benchmarks, sufficient and accurate data must be used which represent the actual market or economic reality that the benchmark is intended to measure. The data must come from reliable sources and the benchmark set using a robust and reliable methodology. The data used to calculate benchmarks must be disclosed or made available to the public, along with information on what each benchmark measures, except when this could have very harmful consequences.

When setting benchmarks, data on transactions must be used where possible; when these are not available, verifiable estimates should be taken as a basis;

— ensure that contributors to benchmarks provide appropriate input data and are subject to appropriate controls. The benchmark administrator must draw up a legally binding code of conduct laying down the obligations and responsibilities of contributors when they provide input data for the benchmark. These obligations also concern the management of conflicts of interest;

— ensure adequate protection for consumers and investors using benchmarks. The proposal enhances the transparency of data used to calculate the benchmark and of the calculation method, what they measure and how they should be used. Moreover, banks must evaluate the suitability of the benchmark used before proposing a financial contract, warning the client if the benchmark is not appropriate (e.g. in the case of contracts for mortgage loans);

— coordinate supervision and applicability of critical benchmarks. The supervision of critical benchmarks will also be entrusted to specific colleges of supervisors, which will be guided by the supervisory authority of the benchmark administrator and other supervisory authorities of other relevant jurisdictions and which will include the European Securities Markets Authority (ESMA). Should the college be unable to agree, the ESMA will decide by means of binding mediation. Further special requirements have been drawn up for benchmarks deemed critical, including the power for the competent authorities to make contribution mandatory.

2.4 Central banks are not subject to the rules as they already have their own guarantees and rules.

2.5 The annexes to the proposal contain detailed provisions on benchmarks for goods and on setting interest rates.

2.6 In order to avoid regulatory duplication, benchmarks for which input data are provided by regulated venues are not subject to certain obligations, when they are covered by other European legislative provisions and by supervision requirements.

3. Comments

3.1 The Committee acknowledges, supports and endorses the work of the European Commission, which, with a heavy work programme and tight timeframe, is working to make the financial services market more stable and efficient. The Committee points out that this is a prerequisite for guaranteeing that the financial sector serves the interests of the real economy.

3.2 The Committee considers this regulation to be in line with the objective of promoting a financial environment which is stable, supervised, more accountable and thus more suited to the requirements of consumers and the economy in general.

3.3 The Committee is extremely concerned that the regulation will not be approved quickly, which will disappoint Europeans, who expect a decisive and vigorous response to manipulation of the market and of instruments showing trends in bonds, securities and benchmarks, which causes enormous damage in a very difficult context. The Committee therefore hopes that the regulation will be approved rapidly, without waiting for the next financial scandal to underscore the need for effective legislation. The Committee points out that the sheer complexity and scope of the proposed regulation could slow down the approval procedure.

3.4 Financial market benchmarks (e.g. LIBOR, EURIBOR for inter-bank interest rates or stock price indices) are an important part of the financial system.
3.5 The integrity of benchmarks is fundamental for pricing many financial instruments, such as interest rate swaps and forward rate agreements, trade and non-trade contracts, supply agreements, mortgages and loans. The value of financial instruments and payments tied to financial contracts depends on these benchmarks, which therefore exert a strong influence on investors and consumers alike.

3.6 According to the ECB, in March 2012, an average of nearly 60% of total loans to the non-financial sector in the euro area was based on variable interest rates, and loans to families based on variable interest rates reached 40% in the same period.

3.7 The recent scandals concerning LIBOR and EURIBOR manipulation (as well as others regarding the manipulation of benchmarks for exchange rates and energy prices) have sparked global doubts and concerns regarding the integrity of benchmarks. The Committee endorses the Commission’s goal of regulating all potential manipulation of benchmarks.

3.8 If benchmarks are distorted (as a result of manipulation or unreliability) and so fail to reflect what they are intended to measure, investors and consumers are harmed and lose confidence in the markets.

3.9 Some benchmarks are national, but the sector as a whole is international. The EU financial services market therefore needs a common benchmark framework which is reliable and used correctly throughout the EU.

3.10 The Commission’s proposed changes to the Market Abuse Directive (2) and the proposed criminal sanctions will allow each case of abuse to be sanctioned appropriately. The Committee reiterates its support for this solution that it has called for on several occasions, particularly in its opinion on sanctioning regimes in the financial services sector (3).

3.11 As the Commission has pointed out, however, changing the sanctioning regime alone will not improve the way in which benchmarks are produced and used; sanctioning does not remove the risks of manipulation arising from the inadequate governance of the benchmark process where conflicts of interest and discretion exist. The Committee strongly endorses this position and supports the need for a system of rules guaranteeing transparency.

3.12 Furthermore, in order to safeguard investors and consumers, benchmarks need to be robust, reliable and fit for purpose.

3.13 The Committee, which has always sought to ensure strong protection for the interests of investors and consumers, is aware of this issue and fully supports this requirement. Investors could benefit because they will be sure that the benchmarks used for their financial instruments are robust and free from manipulation.

To this end, the EESC draws attention to its frequently reiterated request for a European agency protecting users of financial services, along similar lines to what has been achieved in the USA with the Dodd-Frank Act.

3.14 On this point, the Committee attaches great importance to the regulation’s move to further protect investors through specific measures on transparency. The principle of transparency does not mean distributing proprietary information and sending it to competitors; transparency guarantees a business environment where clarity and certainty prevail and competition operates effectively.

3.15 The Committee considers that the proposal could be improved as regards appropriate protection of investors and consumers, guaranteeing enforceable, clear and accessible rights of appeal and rights to compensation. A distinction should be made between the following categories:

— the consumer’s right to appeal regarding the contracted product or service, with flexible, rapid procedures;

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the right to appeal to the administrator, under Article 5(d) of the proposal and Article 5(a) of Annex II. In the event of appeal to the administrator, an arrangement must be found whereby the appeal system is managed by independent third parties who can objectively examine the complaint and decide what action should be taken. The six-month period set out in the Commission proposal appears quite excessive.

3.16 As regards consumer protection, the directive on consumer credit includes rules on appropriate information. The directive on mortgage credit, to be adopted in the near future, also addresses this point. These EU rules on consumer protection do not take account of the suitability of benchmarks in financial contracts; the proposal must be consistent with the rest of the EU’s legal infrastructure.

3.17 The Committee points out that Article 18 must state clearly that evaluating the suitability of the benchmark proposed for the consumer is mandatory (as required by the Markets in Financial Instruments Directive); should it not be suitable, the body subject to oversight must propose a different, more appropriate benchmark.

3.18 In line with the recommendations of the International Organisation of Securities Commissions (IOSCO), the Committee supports the Commission’s intention to use a more objective system for producing benchmarks, based on actual transactions rather than official surveys.

3.19 The Committee supports the broad scope of the principles laid down in the regulation, in line with the principles proposed by the IOSCO and published in July 2013, which potentially covers a wide range of benchmarks.

3.20 At the same time, the Committee suggests that steps be taken to guarantee the proportionality principle as well. Benchmarks vary widely in terms of distribution, meaningfulness and susceptibility to manipulation. The Committee therefore considers that account should be taken of the specific characteristics of individual benchmarks, the way they have been produced and the administrator.

3.21 The discretion granted to administrators to adopt their own methodologies for producing benchmarks might not be enough to guarantee proportionality. The Committee instead suggests fine-tuning the approach set out in the regulation by laying down special rules for critical benchmarks, thus accompanying the more general principles with a set of detailed principles which can take account of the various categories of benchmarks and the potential risks associated with them.

3.22 The Committee believes that this could be the most effective method for plugging potential gaps by introducing appropriate principles without undermining the broad scope of the rules.

3.23 The Committee emphasises the importance of distinguishing between benchmarks, including in relation to potential consequences in emerging markets where benchmarks are important for transparency in information transmission. The Committee therefore recommends tailoring legislation to the degree of systemic relevance of the benchmark in order to avoid obstructing the development of certain markets.

3.24 The Committee is strongly in favour of ensuring that benchmark procedures are subject to civil and criminal penalties in the event of manipulation.

3.25 The Committee considers that benchmark procedures can only be robust and certain if they are guaranteed by good governance. The Committee accordingly endorses the proposal to make the administrator accountable for the integrity of the benchmark and agrees with the Commission that the governance roles and procedures adopted need to be able to deal with potential conflicts of interest.

3.26 In order to improve this provision, the Committee suggests that transparency be made mandatory here.
3.27 In line with the conclusions of IOSCO consultations, the Committee also acknowledges the importance of broad participation in benchmark production, with a view to guaranteeing the key principle of transparency and ensuring that benchmarks are properly representative. The voluntary contribution of input data provided for by the regulation encourages participation, but the Committee proposes that precise rules be laid down regarding the contribution of input data which will guarantee that benchmarks are certain and robust.

3.28 As regards Article 8(3) on internal procedures for reporting breaches of the regulation, the Committee recommends that steps be taken to ensure a flexible, swift and user-friendly reporting process.

3.29 Measures for the protection of whistleblowers are particularly important. The Committee recommends that the rule include a reference to the proposal to amend Directive 2003/6/EC on market abuse, which requires anyone working for a business to report illegal behaviour and explicitly requires the Member States to adopt rules providing for the protection of whistleblowers.

3.30 The Committee considers that measures should be introduced to encourage justified whistleblowing, including by establishing prizes for people who assist the course of justice.

3.31 The Committee endorses the prior consultation of stakeholders affected by any changes in methodology deemed necessary. This approach, particularly in the case of benchmarks which need to be regularly recalibrated, will guarantee continuity in the use of the benchmark.

3.32 It might be useful to make provision for means to circulate and raise awareness of the methodologies used to calculate benchmarks (e.g. publication on websites). The ESMA’s guidelines could establish ad hoc rules.

3.33 The Committee urges the Commission to exercise caution when changing over to new and different benchmarks. This is a sensitive matter as it could cause uncertainty regarding existing contracts, giving rise to controversy and market failure. In such circumstances, one solution could be to maintain the old benchmark, applying the new one only to new contracts.

3.34 The Committee stresses that it is important that the administrator’s statement affirming that the code of conduct complies with the regulation should further specify whether this has been confirmed by a third party. This additional information could help to verify more effectively whether the code is adequate and to establish accountability in the event of breaches of the principles set out in the regulation.


The President
of the European Economic and Social Committee
Henri MALOSSE