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Euribor-EBF's Response to EBA/ESMA Consultation Paper on Principles for Benchmarks-Setting Process in the EU

Introduction:

Euribor-EBF is an international non-profit making association under Belgian law founded in 1999 with the launch of the Euro and based in Brussels (56, avenue des Arts, 1000 Brussels). Its members are national banking associations in the Member States of the European Union which are involved in the Eurozone and the Euro-system¹.

Euribor-EBF has a mission of informing its members, other organizations, the European authorities and the national regulatory authorities on issues relating to the interbank rates. It develops and supports activities related to the Euribor (Euro Interbank Offered Rate), the USD Euribor, the Eonia (Euro OverNight Index Average), the Eurepo (benchmark rate of the large Euro repo market) and the Eonia Swap Index (derivatives market reference rate for the Euro).

It also supports other practical initiatives, fostering the further integration of the European financial market. These initiatives include the improvement of the liquidity and transparency of the short term commercial paper markets, by means of a harmonized framework for short-term European paper 'STEP', in collaboration with the European Central Bank.

Background documentation:

Euribor Code of conduct: http://www.euribor-ebf.eu/assets/files/Euribor_code_conduct.pdf

Euribor Technical Features: http://www.euribor-ebf.eu/assets/files/Euribor_tech_features.pdf

Euribor Panel Composition: <http://www.euribor-ebf.eu/euribor-org/panel-banks.html>

Frequently Asked Questions about Euribor:

<http://www.euribor-ebf.eu/assets/files/Euribor%20FAQs%20Final.pdf>

Euribor-EBF website: www.euribor-ebf.eu

¹ The list of Euribor-EBF National Members Associations is available at <http://www.euribor-ebf.eu/assets/files/euribor-ebf-members.pdf>

Key Points:

- Euribor-EBF welcomes the opportunity to answer the EBA/ESMA Consultation Paper on Principles for Benchmarks-Setting Processes in the EU. Euribor-EBF's response will mainly refer to the Euribor benchmark from an administrator's perspective.
- Euribor EBF wishes to emphasize that this response purports to discuss the possible evolution of the benchmark production and use but is in no way meant to express any comment on the current benchmark production process and the various parties who currently participate in it as well as the parties using such benchmarks.
- Euribor-EBF believes it is appropriate to have a common set of core principles for benchmarks governance but stresses the need to allow enough flexibility to adapt to each benchmark's features. An element of proportionality may help to bring the large variety of benchmarks and indices better into compliance with the principles.
- Euribor-EBF would like to stress the importance of ensuring that principles/regulation/supervision on European benchmarks such as Euribor is coordinated at European and global level.
- Euribor-EBF welcomes EBA/ESMA recommendations on Euribor published in January 2013 set out to further improve the governance and methodology of the index and contribute restoring confidence in the Euribor index.
- Euribor-EBF considers that the benchmark-setting process must rely on a **robust Code of Conduct**, setting out, *inter alia*, a clear definition of the benchmark and transactions to be taken into account (where applicable), clear contributions process guidelines, and sufficient safeguards at contributors' level and calculator agent's level. It should also have in place appropriate and independent oversight functions to enable the benchmark operating effectively and ensuring its quality.
- Euribor-EBF is currently reviewing the composition of the Steering Committee by reducing the number of members from panel banks to a minority and including other classes of stakeholders in order to further develop its independence and diversity.
- With a view to further enhance the accuracy of Euribor, Euribor-EBF is currently elaborating on the clarity of its definition, guidelines contribution criteria and contribution process.
- Euribor-EBF would like to draw EBA/ESMA's attention to the fact, given the impact that any change in methodology may have on the existing benchmarks and, consequently, on the numerous contracts using those benchmarks as underlying, the implementation of those Principles should be carefully assessed and not done in haste. In this regard, the timeframe foreseen in the Consultation Report (Principles to be applicable by April 2013) may not allow sufficient time for careful and robust implementation of the Principles.

Response to Consultation Questions:

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?

The definition of “benchmark” suggested by EBA/ESMA is very broad and covers not only significant benchmarks like Euribor but also a range of indices that are e.g. only created for a handful of clients. Consequently not all principles may be equally applicable to those very different types of indices and benchmarks. To introduce an element of proportionality may help to bring the large variety of benchmarks and indices better into compliance with the principles.

Separately, we would recommend replacing the word “person” by “entity” in the Benchmark administrator definition:

***Benchmark administrator:** Refers to the ~~person~~ entity that controls the creation and operation of the benchmark process, and in particular has responsibility for the calculation of the benchmark, determining the benchmark methodology and disseminating the benchmark regardless of whether it delegates or outsources any of these activities to a third ~~person~~ entity such as a benchmark calculation agent.*

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?

Euribor-EBF welcomes EBA/ESMA recommendations on Euribor published in January 2013 set out to further improve the governance and methodology of the index and contribute restoring confidence in the Euribor index. Those recommendations could serve as a basis for best practice Principles applicable to other benchmarks.

Euribor-EBF believes it is appropriate to have a common set of core principles for benchmarks governance but stresses the need to allow enough flexibility to adapt to each benchmark’s features. Please also refer to our argument concerning proportionality in Question 1.

In addition, Euribor-EBF would like to stress the importance of ensuring that principles/regulation/supervision on European benchmarks such as Euribor is coordinated at European and global level. In this context, there is a need for a harmonized supervisory

framework and improved coordination between supervisors at both national and European level.

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?

Euribor-EBF agrees with the general principles cited in section A of the Consultation Paper.

Anyway it should not be underestimated that requirements to use actual transactions (A.1) may under certain circumstances also lead to a volatile benchmark. It could be e.g. the case for a market that has run dry and where the fixing then relies only on a few transactions – making the fixing additionally also more prone to wrongdoing. The inclusion of expert estimates as a legitimate practice will help to avoid the negative consequences and a disruption of the market.

In general, provisions should be made for situations where a liquid market temporarily dries up but this should not trigger a direct suspension of the benchmark with potentially very negative consequences for the market.

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?

Euribor-EBF generally agrees with the principles for submitters cited in section B of the Consultation Paper.

Euribor-EBF believes that a **strong contribution process** must be defined by the Administrator and implemented by the submitters. Euribor-EBF has been defining written guidelines on the contribution process and general responsibilities, including *ex-ante* and *ex-post* controls and organizational and administrative arrangements with a view to avoid potential conflicts of interests:

Determination of the contribution:

- There should be a clear **definition of roles** in the contribution process and **segregation of duties (physical and systems)** of the contribution team in order to manage and reduce conflicts of interests. This means that, in any case, conflicts of interests between the employee responsible for the quotes and Money Markets Desks (respectively Derivatives Traders) must be avoided when possible, and reduces to the minimum when not possible.

- In addition, **contributing professionals should receive appropriate training** and confirm understanding of rules and policies. **Panel banks should appoint authorized persons to make the contribution.**
- The **responsibility of Euribor submissions should be at Treasury senior management level.** The daily contributions should be done by an operational team under the control of the senior management. Treasury departments have strong market knowledge, having daily involvement in the cash balance sheet management, as well as a complete view of the degree of price liquidity in the market.
- **Four-eye principle and pre-submission control:** The **quality of the contribution** should be reviewed by a neutral group within the bank with no P&L responsibility but sufficient market expertise about the Euro cash market (e.g. Market Risk Department), taking into account evolution of interest rate level, market criteria, ECB rates with appropriate levels of alerts (thresholds).
- In case the neutral group has any issues or concerns with the respective panel Bank's contributions, the panel bank should implement a well-documented escalation process within its organisation. The panel bank should implement an information and communication process between the business and the neutral control group. Any communication or exchange of views during the pre-submission control process should be well documented on a daily basis.
- The panel bank should ensure through specific and detailed guidelines and policies that the processes for the Euribor submission, in general, and for determining the Euribor contributions, in particular, are transparent and well documented, that is, information, comments, and data used for determining the contribution rates should be stored according to the respective archiving requirements.
- A panel bank's contribution rates should be classified and treated as confidential, non-public, price-sensitive information prior to their publication on a daily basis. The respective bank internal key operating procedures, guidelines, and policies should represent the basis for this classification.

Submission of the contribution:

- The contribution team, under the supervision of the Treasury senior management, should be responsible for inputting the rates into the calculator agent's system, once it is validated by the Market Risk Department (or other neutral group as described above).
- A 'four-eye' principle should also be applied when inputting the rates, in order to avoid any mistyping mistakes.
- Panel bank must also ensure the correct and timely submission of its contribution rates to the calculation agent by implementing processes and procedures. (An automatic reminder procedure is already in place on the calculator agent's side.)

- Panel banks must communicate the names of the contributing persons and senior management responsible to Euribor-EBF and the calculator agent. (Already in place through a contact form to be returned to Euribor-EBF on an annual basis). Any change in the contact list must be communicated without delay to Euribor-EBF and the calculator agent.
- Recordkeeping of contributors' names, internal communications, argument for contribution and data related to the process for a set period of time, in particular when there are different opinions on the rate, must be ensured.
- The system(s) used for the submission process must meet minimum security standards in order to avoid unwanted, uncontrolled changes and amendments to the contribution rates (e.g. personal logins, passwords, etc.)

Post-submission controls

- In addition to the pre-contribution control, the **Market Risk Department** (or other neutral group as described above) should review and analyze the bank's contributions over a wider time horizon (e.g. one calendar month) in close cooperation with other stakeholders within the bank on a regular basis (e.g. monthly review meeting).
- The **Compliance Department** should be in charge of controlling **the internal contribution processes and respect of the Code of Conduct**. The Compliance department should be able to review the process on real-time basis.

Internal audit

- Each panel bank should ensure that the internal audit department regularly reviews, checks, and validates all processes and procedures relating to the Euribor submission.

These contributions guidelines are aimed to be annexed to the Euribor Code of Conduct. In addition, submitters should be required to detail their processes to the Administrator.

With regard to the above-mentioned common contributions guidelines, Euribor-EBF acknowledges that banks' internal structures may differ significantly from one to another and that some adjustments might be necessary.

In addition to the above-mentioned contributions guidelines, Euribor-EBF acknowledges the need that submitters have clear internal sanctions and adequate remuneration policies, but considers it should remain the responsibility of the contributing company.

What is more, the public declaration of compliance (B.11) would likely create liability risks for the submitters (esp. civil) on an unforeseeable scale. Consequently such a declaration

could have a deterrent effect and may thwart the political objective to strengthen benchmarks and especially encourage broad participation. It should be considered to drop this principle.

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?

Euribor-EBF generally agrees with the principles for benchmark administrators cited in section 3 of the Consultation Paper except of principle 9.

Euribor-EBF considers the benchmark-setting process must rely on a **robust Code of Conduct**, setting out, *inter alia*, a clear definition of the benchmark and transactions to be taken into account (where applicable), clear contributions process guidelines (further detailed under question 4) including sufficient safeguards at contributors' level and calculator agent's level and appropriate sanctions from a supervising authority. It should also have in place appropriate and independent oversight functions to enable the benchmark operating effectively and ensuring its quality.

More specifically, Euribor-EBF would like to comment on the following supporting principles:

- **C2: Governance/Compliance functions:**

Euribor-EBF is currently reviewing the composition of the Steering Committee by reducing the number of members from panel banks to a minority and including other classes of stakeholders in order to further develop its independence and diversity. In addition, according to the Euribor Code of Conduct, "All the members must be independent and not subject to instructions from the companies or organisations to which they belong". Euribor-EBF believes that market participants' expertise is crucial in order to ensure that the measures taken at Euribor-EBF and/or regulatory/supervisory fit the market's needs.

In addition to the above-mentioned Steering Committee, Euribor-EBF is in favour of the creation of an independent body responsible for identifying and managing potential conflicts of interests. While the composition of such committee is still to be determined, Euribor-EBF believes that it should be independent from the banking sector and include audit, compliance and/or legal experts. This Committee should have regular meetings and transparent procedures regarding its membership, processes and decisions.

- ***C3: Well-defined criteria for the calculation of benchmark, including panel composition criteria, calculation methodology and provision regarding operational continuity:***

In addition to the contribution process guidelines detailed under question 4, Euribor-EBF is currently elaborating on a clarification of the “prime bank” and “interbank transactions” terminology of the Euribor definition in order to provide contributing firms with further guidance.

The Code of Conduct must define clear criteria to apply for and stay on the panel, as well as the procedure followed by the Steering Committee to review new applications. The Steering Committee must also review the panel composition at each meeting (bi-monthly).

Similarly, the benchmark’s Code of Conduct or the technical features of the benchmarks must define clear **re-fix rules, contribution window and fallback provisions**.

- ***C4/C6: Disclosure of methodology and transparent and determined process with regard to any amendment to an established methodology:***

Euribor-EBF agrees that the benchmark criteria, processes and governance must be clearly defined and transparent.

In this context, Euribor-EBF publishes, on a free access basis, delayed daily rates (90mn after the fixing time) and individual submissions. The Code of Conduct and the technical features of the benchmarks, setting out the governance, setting methodology, including fallback provisions in case insufficient data is available are also publicly available. Similarly, the composition of panel and the Steering Committee as well as the minutes of its meetings are available on www.euribor-ebf.eu.

While the Steering Committee is responsible for the benchmark’s governance and technical changes, market participants must be directly informed, in a reasonable timeframe, and, when possible, consulted about changes in the Code of Conduct and technical features of the benchmark.

- ***C5: Regular review of the representativeness of the benchmark:***

The representativeness of a benchmark should be reviewed on a regular basis, in particular in turbulent market conditions.

At every meeting, Euribor Steering Committee members review the level and use of the index and how it reflects market conditions, the composition of the panel and the compliance of panel banks with their obligations under the Code of Conduct. Under these items, they

discuss whether the index definition and features are in line with the market, whether the panel is large and representative enough, and review the individual submissions of panel banks (top/bottom 15% contributions; any missing contribution).

The number of Euribor Steering Committee meetings has been increased to bi-monthly meetings.

- ***C7: Procedures to enable the oversight function to report to their respective competent authorities***

Euribor-EBF agrees that the Administrator should immediately address any failure to comply with the benchmark's processes and governance it becomes aware of and alert the competent authorities. Meanwhile, Euribor-EBF considers that it is the regulator's responsibility to provide the Administrator with the procedure to alert the relevant Authority.

- ***C8: Record and publication of minutes of relevant meetings and interactions between the oversight function, contributing firms and benchmark calculation agent***

Euribor-EBF agrees that minutes of the relevant meetings and interactions between the oversight function on the one hand, and contributing firms and benchmark calculation agent on the other hand should be recorded and published. With a view to further enhance transparency, minutes of the Steering Committee will be published promptly after the meetings, once approved by the Chair and Committee members.

- ***C9: The governance/compliance function of a benchmark administrator should ensure that principles applying to contributing firms in order to prevent any misconduct are implemented***

Generally a benchmark administrator cannot have the authority to ultimately ensure that principles are implemented within the entity of a contributing firm. This is and should be the task of the competent supervisors.

Additionally Euribor-EBF believes that principles relating to internal sanctions and remuneration policies should remain the responsibility of the contributing firms.

Notwithstanding this, Euribor-EBF will annex contributions guidelines to the Euribor Code of Conduct, to which panel banks must subject themselves unconditionally. In addition, panel banks will be required to detail their processes to the Administrator.

Separately, Euribor-EBF believes that regular audit of the submissions must be held on a regular basis by the Steering Committee, including supervisor representatives. In this

perspective, the number of Steering Committee meetings will increase to bi-monthly meetings. Should the Steering Committee consider that panel banks do not comply with their obligations under the Code of Conduct, they (1) send a warning to the relevant banks and ask them to remedy the situation quickly and (2) if such warning is ignored, they can suspend or exclude the contributor (see article 7 of the Code of Conduct: Sanctions).

- ***C10: Adequate internal control mechanisms on the data contributed, including consistency checks on the basis of transaction-based or other verifiable data where available, and control on the benchmark computation process at the level of the benchmark calculation agent***

Euribor-EBF believes that **substantive back-testing** of the quoted rates must be performed by the calculator agent and the Administrator, with report to the Steering Committee. In this context, the Administrator and the calculation agent must ensure that **robust and transparent controls and safeguards during the collection and calculation process** are in place in order to detect any incorrect or unusual submission, and that Administrator and Calculation Agent have in place a specific Code of Conduct.

Euribor-EBF would like to point out that, when a market becomes illiquid or with very few transactions for some maturities, it might be difficult to justify the experts' estimations only on transactions based or verifiable data. In addition, for the specific case of Euribor, panel banks do not quote a price reflecting their own position in the market, but the rate that each panel bank believes one prime bank is quoting to another prime bank for interbank term deposits within the Euro zone. It relies on an expert judgment of the market, by the market. Consequently transaction-based verification is currently not feasible. A plausibility check, to the extent possible should be called for in this context.

Finally, Euribor-EBF believes that a 'four-eye principle' (cross checking by different parties) on the calculation process run by the calculator agent should be performed by the European Supervisor.

- ***C11/C12: Adequate access and control on the activities of the calculation agent, including its compliance with the methodology of the benchmark***

Euribor-EBF agrees that the Administrator must have adequate access and control on the calculation agent's activities related to the benchmark's computation. In this context, the calculator agent should have its own Code of Conduct related to the benchmark's computation, and disclose all processes and data to the Administrator.

Euribor-EBF also agrees that the calculation agent should perform internal audits with regard to its compliance with the Principles set out in section D of the Consultation Paper and with the benchmark's methodology.

In addition, the Administrator should perform a yearly audit on the calculation agent.

- ***C13: Whistleblowing mechanism in order to ensure early awareness of any misconduct or other irregularities***

Euribor-EBF believes that such mechanism must apply at different stages: (1) at the contributors' level, with extensive *pre-* and *post-*controls; (2) at the calculator agent's level, with robust and automatic controls and safeguards with regard to the individual submissions; (3) at the Administrator's level, with substantive back-testing and report to the Steering Committee and (4) at Supervisory authority level, which Euribor-EBF believes it should apply 'four-eye principle' (cross checking by different parties) on the calculation process run by the calculator agent should be performed by the European Supervisor.

Euribor-EBF also concurs that, when/if the Administrator, the calculation agent and/or the contributing firm become aware of any failure to comply with the benchmarks' methodology and governance, the Administrator should address the issue immediately and alert the relevant Regulatory Authority. As expressed previously, Euribor-EBF considers that it is the regulator's responsibility to provide the Administrator with relevant procedure to alert the relevant Authority.

With regard to whistleblowing mechanisms it would be excessive to require each submitter to set up such an instrument solely for the benchmark compliance. It should be sufficient if the benchmark administrator had a whistleblowing mechanism in place.

- ***C14: Public disclosure of a confirmation by the relevant entity of the relevant authority of compliance with the above principles***

Euribor-EBF agrees that the Administrators' processes and governance structure should be subject to both internal and external audits, followed by public disclosure of the results.

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?

Euribor-EBF agrees with the proposed Principle for benchmark calculation agent. In addition, Euribor-EBF would like to point out that, while the Administrator should define its expectations regarding procedures and controls being applied by the calculation agent and retain adequate control on the activities of the calculator agent, the calculation agent must have the responsibility to ensure that it has in place robust safeguards and controls in order to prevent from any irregularities in the benchmark's computation. In this respect, the

calculation agent should have its own Code of Conduct and disclose all information relevant to the computation's process on a real-time basis to the Administrator.

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?

Euribor-EBF agrees with the proposed Principles for benchmark publishers.

Regarding Principle E3, Euribor-EBF believes that a 'four-eye principle' (cross checking by different parties) on the calculation process run by the calculator agent should be performed by the Administrator and the European Supervisor before publishing benchmark data.

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?

As Euribor-EBF focuses on the consultation from the perspective of a benchmark administrator Euribor-EBF would not like to comment on the user's perspective.

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.

As far as Euribor-EBF benchmarks' are concerned, Euribor-EBF believes that the above principle would be adequate except for the reservations mentioned.

More broadly and as also mentioned in question 1 some general principles are not entirely suitable for customized proprietary indices that are rather specific in nature.

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?

Euribor-EBF would like to draw EBA/ESMA's attention to the fact, given the impact that any change in methodology may have on the final benchmarks and, consequently, on the numerous contracts using those benchmarks as underlying, the implementation of those Principles should be carefully assessed and not done in haste. In this regard, the timeframe foreseen in the Consultation Report (Principles to be applicable by April 2013) may not allow sufficient time for careful and robust implementation of the Principles.



Each benchmark reflects a specific and unique economic value. A benchmark can thus only be exchanged for another where the underlying data is sufficiently comparable so that it performs a similar function. Material changes to the underlying method of calculation, definition or composition must not alter the nature of a benchmark to such an extent that it may no longer be suited to serve its original function.

Additionally, it would be extremely challenging from a practical and legal perspective to procure a legally binding and enforceable replacement of an existing benchmark or a materially altered benchmark since this would require the identification and subsequent amendment of all agreements and/or replacement of financial instruments containing the (direct or indirect) reference to the benchmarks in question - which in many instances will result in protracted negotiations.

In the end it will not be possible to fully replace an existing benchmark by another or materially amend the manner in which it is calculated, defined or composed in short term. Rather, any such replacement or amendment will require an extended transition period during which it will be necessary to ensure the continuation of any existing benchmark. Furthermore, this also means that any new regulatory requirements for benchmarks have to provide for such transition periods in respect of existing benchmarks.

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