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Benchmarks; European Commission's Proposal

The Division Bank and Insurance of the Austrian Federal Economic Chamber, as representative of the entire Austrian banking industry, appreciates the possibility to comment on the European Commission's Proposal for a Regulation on indices used as benchmarks in financial instruments and financial contracts and would like to submit the following position:

General remarks

While we acknowledge the efforts of the regulator to improve benchmark-setting in the light of recent LIBOR / EURIBOR issues, we also believe that regulations need to recognize that panel banks submit themselves voluntarily to an operational regime that is challenging and difficult to maintain, carrying significant risk for operational error.

Consequently, we welcome guidance for a robust process, but also believe that some sanctions create unacceptable reputation risk given that panel banks contribute on a voluntary basis. In our opinion banks should only be exposed to public disclosure of sanctions in case of fraud or collusion.

Additionally, regulation should be limited to benchmarks that are systemically relevant, taking into account a principle of proportionality. It seems necessary to strike the right balance between necessary regulation and unnecessary bureaucracy. As a matter of fact, the regulation proposal sets out a very broad scope of application, targeting each and every possible benchmark. We think that the scope should be narrowed and furthermore propose to insert an additional threshold for application, below which the regulation should not apply (please refer to our specific comments below).

The regulation proposal is in its principle intention designed to regulate global benchmarks with big volumes. Indeed, we feel that such a regulation could in general be applicable to this kind of benchmarks, however, its application to small markets could cause market disruptions other than those intended to be prevented by this proposal. In its effect, small credit institutions will probably face disadvantages. As laid out in the Explanatory Memorandum, the proposed regulation is described to be proportionate, in terms of the

direct or indirect economic impact of benchmarks if they are manipulated, and in terms of a differentiation across sectors and types of benchmark. However, we think that a proportionate approach should also include a reference to the market size, which is impacted by a certain benchmark.

As regards conflicts of interest, we think that the question of their management is interlinked with the question of how many contributors, independent from each other, are contributing to a benchmark. Although we think that for contributors conflicts of interest will in most cases persist, we believe that the higher the figure is, the lower the impact of the single contributor is, the lower the relevance to target possible conflicts of interests within one contributor will be. This has clearly been shown by the LIBOR-issue. With regard to critical benchmarks we argue for a clear determination of a) critical benchmarks and b) mandatory contributors for each country with criteria to be clearly defined, as the most efficient way to avoid abuse.

Finally, we are concerned of the number of delegated acts foreseen in the proposal. Substantial parts of the regulation will be determined at a later stage, such as governance requirements, controls of input data, code of conduct for contributors, system and controls requirements for contributors, etc., which makes it difficult for us to estimate the potential impact of the regulation. Moreover, this approach does not contribute to legal certainty. We therefore plead for the incorporation of more details concerning the planed delegated acts directly into the regulation. We would also like to draw your attention to the fact that, particularly in the case of governance rules, short transition or implementation periods would make it very difficult to set up new reporting or organisational structures or to change internal policies.

Specific remarks

- Article 3 / Definitions
    - Index: As regards the definition of “index”, the 3 proposed conditions should be cumulative.

    - Benchmark: As regards the definition of benchmark, an alignment with, or a reference to the definition of benchmark in the MAR seems to be advisable.

    - Critical benchmark: It is unclear how the threshold of 500 billion EURO can be determined, particularly in the context of data gathering. Although Art. 13 stipulates that the Commission shall adopt a list of critical benchmarks it is important to understand how the calculation method works. With this in mind, the threshold should possibly be reviewed with view to increasing it.

  In addition to a threshold determining a benchmark to be critical, we suggest to introduce a de minimis threshold determining a benchmark to fall under this regulation. This would contribute to the proportionality of the regulation. We feel that such a threshold should be set at 1 billion EURO. As a consequence, only benchmarks that reference financial instruments having a notional value above 1 billion EURO would fall within the scope of this regulation.

- Article 7 / input data and methodology
  In order to prevent input errors or inaccurate input data for critical benchmarks, we propose to require administrators to provide a technical infrastructure for submitting

quotes in form of an advanced interface that provides for controls, a 4-eyes-principle, warnings, plausibility checks, etc. In case of absence of such a central infrastructure we see the danger that a plethora of solutions in contributing institutions will additionally create criticism from regulators or auditors.

- Article 11 / Governance and Controls; Annex I Section E; Annex II
  As already pointed out in the general remarks above, we would like to note that we object to the large number of delegated acts required, particularly regarding the systems and controls of a contributor on substantial requirements that will only be available at a late stage of the legislative process.

  In particular, we would like to refer to the requirements for submitters. On the one hand input data are required to be integer and reliable, which assumes an expert knowledge of the person actually submitting input data that can only be ensured if the person is "close to the market" (e.g. traders). On the other hand, employees (submitters and traders) should be physically and organizationally separated wherever possible in order to avoid conflicts of interest. In our view such requirements neglect market reality to a certain extent. Organizational requirements, such as reviews by Compliance as well as Internal and External Audit duplicate activities and add to the administrative and financial burden.

  On the whole, an implementation of the regulation that can reliably be undisputed appears to be very hard to achieve.

- Article 13 / Critical benchmarks
  Further to our comments to critical benchmarks above regarding the calculation method we would like to have clarified in which intervals the Commission is obliged to update the list of critical benchmarks.

- Article 14 / Mandatory contribution
  In general we do not agree with the approach of forcing contributors to contribute to a benchmark. In our view this is a discriminatory practice and is not compatible with a benchmark provided by private institutions on a voluntary basis.

  However, we feel that in the case of critical benchmarks it would be fair to set up clear and transparent rules regarding the benchmarks concerned and the actual contributors.

  With regard to the actual content of the article, we would like to highlight the following material issues:
  - The basis of calculation for 20% of contributors should be specified: do the 20% refer to the number of contributors at the date of the entry into force of this regulation?
  - The terms "sufficient indication" and "likely to cease contribution" should be specified by clear and transparent criteria, otherwise they leave too much room for interpretation by the authority.
  - The reference period – "in any year" – should be further determined in terms of starting and end date of a year.

- Furthermore we have major doubts as regards the legitimacy of the power which is given to the authority of the administrator of the relevant benchmark to require supervised entities of another jurisdiction to contribute input data.
- We would suggest to include a transitional period before the regulation applies to a mandatory contributor. Sufficient time should be given to a mandatory contributor in order to enable it to adapt its organizational and IT structure to the requirements. In this context we would also like to state that, at least for some contributors, such adaptation could be costly. We could not find any indication on how this effort is intended to be reimbursed.
- As to paragraph 4(b), we would like to have more information on how the local authority will be able to judge if an acceptable substitute benchmark is available.

- Article 17 / Cessation of a benchmark
  We believe that the cessation of a benchmark will have effects across the entire financial industry, and it is therefore important to highlight that any such phasing-out or switch to an alternative benchmark requires the careful planning of a coordinated approach across the industry. As such, individual banks are not well positioned for robust planning of such events. The responsibility should better rest with the administrator of the benchmark being discontinued.

- Article 18 / Assessment of suitability
  We view this article with particular scepticism and think that it should be clarified that this provision will not require a bank to perform regular reviews of all benchmarks used in financial contracts.

  It should also be clarified that for financial contracts, which were concluded prior to the entry into force of this regulation, Article 18 will not apply.

- Article 31 / Sanctions
  Given the strict governance rules set forth in Article 11, including the consequences described in our comments, operational risks cannot entirely be excluded and could cause a significant burden, as the potential impact is very high and exposes a bank worldwide. Hence, participation in benchmarks creates significant operational (legal) risk that is not compensated for. While the economy and the financial industry as a whole benefits from reliable benchmarks, considerable direct and indirect costs incur for participating banks, due to the implementation of segregation, but do not receive compensation in return. Furthermore, it is assumed that the cost of external review has to be borne by the bank. Therefore, a structure should be sought that allows participating banks to receive fees commensurate to their share in the benchmark from the (local) financial industry.

  Finally concerning concrete proposals on sanctions, we question when and whether withdrawal or suspension of business license would be a proportionate measure.

Kindly give our remarks due consideration.

Yours sincerely,

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