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Your ref: CP 12/36

Florian Nitschke  
Market Infrastructure and Policy (MI&P)  
Financial Services Authority  
25 The North Colonnade  
Canary Wharf  
London E14 5HS

Via email: [cp12\\_36@fsa.gov.uk](mailto:cp12_36@fsa.gov.uk)

Dear Florian

**ICAEW Rep 04/13 – Our response to CP 12/36 The regulation and supervision of benchmarks**

ICAEW is pleased to respond to your request for comments on *CP 12/36 The regulation and supervision of benchmarks*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

Philippa Kelly

**T** +44 (0)20 7920 8446  
**E** [philippa.kelly@icaew.com](mailto:philippa.kelly@icaew.com)



## ICAEW REPRESENTATION

### CP 12/36 The regulation and supervision of benchmarks

Memorandum of comment submitted in January 2013 by ICAEW, in response to the Financial Services Authority (FSA) consultation paper *The regulation and supervision of benchmarks* published in December 2012.

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## INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper *12/36 The regulation and supervision of benchmarks* published by the FSA on 5 December 2012, a copy of which is available from this link. <http://www.fsa.gov.uk/static/pubs/cp/cp12-36.pdf>

## WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 140,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
4. The Financial Services Faculty was established in 2007 to become a world class centre for thought leadership on issues facing the financial services industry acting free from vested interest. It draws together professionals from across the financial services sector and from the 25,000 ICAEW members specialising in the sector and provides a range of services including a monthly magazine *FS Focus*.

## MAJOR POINTS

### Support for the initiative

5. We support the initiative of the FSA and future FCA in seeking to restore the credibility of LIBOR through increasing its integrity, by further formalising the way in which the benchmark operates and introducing regulatory supervision and oversight as a deterrent to future actual or attempted manipulation.
6. ICAEW's priority in this area is how the work of auditors can help support confidence in the integrity of LIBOR, primarily through the provision of assurance over LIBOR submissions and compilation as required by regulation and demanded by the market in the future. To this end ICAEW is set to publish *Guidance for the Performance of Assurance Work on Benchmarks and Indices* in the early part of this year.

### Other considerations

7. When considering the rules for LIBOR submission it must be borne in mind that judgements have to be made in the submission of LIBOR, even in fully liquid markets. For example trades made, even in high volume, may not be representative of the definition due to size or counterparty for example. As such those responsible for submission make judgements about the adjustments required to use actual trade data to meet the LIBOR definition, which adds inherent complexity to the process.
8. We infer from the cost analysis provided as part of the consultation that the expectation would be that the industry would have to pay for LIBOR calculations, but how this is expected to work is not detailed. More information about how LIBOR data provision is to become a commercially viable endeavour for the administrator is required. It would also have to be debated how LIBOR can be fairly paid for and appropriate access to the data ensured, given the current free and unencumbered use of the benchmark by market participants at present.

## RESPONSES TO SPECIFIC QUESTIONS/POINTS

**Q1: Do you agree that our suggested capital requirements for the administrator will give enough time for an orderly transition to a new administrator?**

9. We believe that capital requirements sufficient to maintain the operation of the benchmark in the event of administrator stopping or being forced to stop carrying on the activity would be highly beneficial, not least to ensure stability given the immense financial value of contracts reliant on LIBOR.
10. We do not disagree that six months running costs plus a three month buffer is reasonable. Depending upon the nature of the new administrator there may, however, be conceptual and pragmatic difficulties in assessing and monitoring the required capital buffer. Also, a capital buffer does not impact upon the integrity of the benchmark. Business continuity is a key concern, but sufficiency of resources in the event of such problems may be best addressed in a different way, for example through professional indemnity insurance.

**Q2: Are there any other rules we should consider for the administrator?**

11. We generally agree with the proposed rules and, if enacted as set out, feel they would address many of the weaknesses inherent within the nature of LIBOR currently.
12. The enacted rules must be sufficiently clear and precise to avoid an 'expectations gap' (similar to that found within any audit or assurance engagement) about what the administrator of the benchmark is or is not accountable for.
13. Some of the rules proposed have the potential to significantly increase the time requirement and cost of administering a regulated benchmark. In particular, the administrator requirement to '*Corroborate the submissions of individual submitters, identify breaches of submission practice standards, and notify the FCA when it suspects attempted or actual manipulation.*' (para 2.5) needs to be clearly understood and defined.
14. The standard of 'corroboration' could vary greatly, from the benchmark administrator questioning outliers or submissions which deviate from that of the previous day with no discernible reason, to an audit style corroboration of vouching the submission made to source documents or calculations made by the submitter. Depending on who becomes the administrator, there may be pre-existing relationships which give rise to a conflict of interest if there is a high standard of corroboration required.
15. Given that corroborating submissions is a significant expansion of the role of the administrator and likely to be costly, as well as attracting potential liability, it may deter potential administrators.
16. Such corroboration processes are more likely to be associated with closed 'pay to play' type benchmarks, which are very much opposite to the way in which LIBOR is used by the wider market. These requirements may also place inherent limitations on the type of firms which would be able to become administrators, for example accounting firms would be unlikely to be able to do so due to their independence requirements.
17. We appreciate that the FSA has taken a pragmatic approach and not ruled out waiving or altering rules depending upon the way in which benchmark administration and compilation is carried out by a particular entity.
18. We consider quarterly publishing of aggregated statistics to be an improvement to current practice. It should promote greater stability by reducing the signalling effect of daily publication of named submissions.

19. We note that it is proposed that the benchmark submitter will retain records in relation to submissions for five years. Submitters are also required to *'provide to the relevant benchmark administrator all information used to enable it to make benchmark submission on a daily basis...'* (rule 8.2.9 [2]) The benchmark administrator is then required to provide the FCA all submissions received on a daily basis. The rules do not detail the retention period of these benchmark related documents for the administrator or the FCA. We would recommend the retention period for the administrator is also specified and congruent with submitter retention. (See also Question 5.)

**Q3: Do you agree with our proposals for charging fees from the benchmark administrator?**

20. The fee suggested of £385,000 appears high. As mentioned above this may dis-incentivise entities wanting to become an administrator depending upon how they are able to make the benchmark a commercial endeavour. We would welcome further information about how the proposed fees have been calculated, and what consideration the FSA has given to the impact upon competition.

**Q4: Do you think there are any other rules we should consider for the submitters?**

21. The submitter rules appear overall to be sensible and practical. We especially support the involvement of compliance, governance and internal and external audit in the oversight of LIBOR submitting. It is crucial that there are the highest standards of integrity, governance and controls in submitting firms.

22. Where the rules would require submitters to *'provide to the relevant benchmark administrator all information used to enable it to make benchmark submission on a daily basis...'* (8.2.9[2]) we presume this is to allow the required corroboration of submissions by the administrator. This does however raise issues around the sharing of commercially sensitive data, and of data security, amongst other things, all of which will add, not insignificantly, to the cost of the benchmark. We would encourage the FSA/FCA to consider the processes around this and how they would like the administrator to deal with the large volumes of information.

**Q5: For what period should submitters be mandated to keep records?**

23. We do not disagree with a retention period of five years. Given documents are to be sent on a daily basis from the submitters to the administrator and from the administrator to the FCA, we would suggest the same retention period be used by all. For consistency purposes, it could be useful if records were kept in line with Companies Act 2006 s 388 (4) requirements for books and records, being a period of six years for a public company.

**Q6: How frequently do you think the external audits should occur?**

24. An annual external assurance opinion should be sufficient to increase confidence in LIBOR, whilst also being practicable for submission banks, the LIBOR administrator, and their external assurance practitioners.

25. Given there will be quarterly publications of statistics, the FCA may wish to consider whether they would like some form of assurance also to be provided in advance of this publication.

26. Due to the nature of the assurance work likely to be undertaken by practitioners (for further details please refer to *Guidance for the Performance of Assurance Work on Benchmarks and Indices*) procedures may be performed more frequently and at different time throughout the year but we would not consider it necessary for an opinion to be issued in each instance.

27. We would also like to point out that following consultation with accounting firms we consider the estimated costs of external assurance as proposed in the paper (£45,000 per annum) to be rather low, especially for year one costs. Given its definition, LIBOR is not a simple

benchmark and currently is very high profile. As such the inherent risks of an assurance engagement are increased. Firms will have to ensure they have staff of suitable experience to enable them to make the professional judgements needed. Whilst there is not a detailed scope for this sort of assurance work at the present time, we believe the costs of assurance may be significantly understated by the FSA, perhaps even by a multiple of the estimated £45,000.

**28.** The cost would be significantly higher if the work was not performed by a bank's external auditor. The latter's capacity to act would of course be affected by auditor independence rules (specifically the value of non-audit engagements).

**Q7: Do you agree with our proposals to apply the new CF40 controlled function regardless of where the submitting activity takes place?**

**29.** It does not seem unreasonable for the CF40 to apply regardless of where the submitting activity takes place if the submitting bank is established in the UK or passported into the UK.

**30.** Monitoring and enforcement of this by the FCA would be done in a fair, efficient and effective manner, given the very high likelihood that submitters will be based across the world given the proposed panel banks and the high number of submitters (thirty to fifty banks with a submitter for each currency) who will be required to become CF40s. We would also like to understand the FSA's approach to individuals who are CF40s sitting outside the UK as substantive submission is likely to take place in locations such as New York and Tokyo for some currencies and tenors.

## **DISCUSSION PAPER**

**DP1: Do you agree that the specific indicators and methodology we have identified adequately capture those institutions that will maintain the integrity of LIBOR rates?**

**31.** We have no specific points which we wish to raise in response to this question.

**DP2: What are your views on how many institutions should form the 'super-set' that contributes to LIBOR?**

**32.** We agree that the quality and integrity of LIBOR will increase with the number of participants, provided all participants are undertaking a reasonable volume of business in a given currency and tenor.

**DP3: Do you agree with our approach to determining currency expertise?**

**33.** The approach appears broadly reasonable, but we do not have specific points which we wish to raise in response to this question.

**DP4: What do you think is the best process for expanding the LIBOR panels and encouraging firms to participate?**

**34.** Voluntary participation is key to underpin quality. We would also warn against excessive panel sizes as wholesale financial markets are naturally concentrated in nature, and the inclusion of small institutions with comparatively low business volumes may undermine the desired quality of the benchmark.

**DP5: Do you agree with our proposed approach for determining the circumstances in which the FCA would take up its powers to require submission to LIBOR?**

**35.** The approach appears broadly reasonable but may conflict with requirements for submissions to be based on empirical trade data to the fullest extent possible, should markets become illiquid for particular banks at a micro level or markets at a macro level.

E [philippa.kelly@icaew.com](mailto:philippa.kelly@icaew.com)

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