ICAEW REPRESENTATION
138/14

IMPLEMENTATION OF THE FAIR AND EFFECTIVE MARKET REVIEW'S RECOMMENDATIONS ON BENCHMARKS

ICAEW welcomes the opportunity to comment on the consultation paper *Implementation of the fair and effective market review's recommendations on benchmarks to bring into UK regulatory scope* published by HM Treasury on 25 September 2014, a copy of which is available from this link.

This response of 24 October 2014 has been prepared on behalf of ICAEW by the Financial Services Faculty. As a leading centre for thought leadership on financial services, the Faculty brings together different interests and is responsible for representations on behalf of ICAEW on governance, regulation, risk management, auditing and reporting issues facing the financial services sector. The Faculty draws on the expertise of its members and more than 25,000 ICAEW members involved in financial services.

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MAJOR POINTS

Support for the initiative

1. We support the work of the Bank of England, Financial Conduct Authority and HM Treasury in examining fixed-income, commodity and currency benchmarks and considering how they can be improved to restore confidence in benchmarks that has been eroded by the LIBOR and foreign exchange scandals, amidst an enduring lack of trust in the wider banking and financial services sector.

2. ICAEW published guidance entitled *Assurance Reports on Benchmarks and Indices*[1] in February 2014 which facilitates the provision of external assurance for benchmark submitters and price reporting agencies amongst others, and would be pleased to provide further information on the benefits and practicalities of external assurance.

RESPONSES TO SPECIFIC QUESTIONS

Q1: Are the criteria set out above (and in further detail in section 2 of the review's report) the appropriate ones to use?

3. We consider the criteria to be appropriate.

4. We support a principles based definition of 'major' which will allow the HM Treasury and the Financial Conduct Authority to respond to new and changing benchmarks.

Q2: Are there other criteria that should also be included?

5. We think the criteria are sufficient to capture the most relevant benchmarks for further regulation.

Q3: Do these benchmarks meet the criteria?

6. We agree that the seven specified benchmarks meet the criteria. However, we would seek a more precise articulation of the benchmarks referred to as 'ISDA Fix' (which covers approximately 60 separate benchmarks), WRM fixings, of which there are a multitude and ICE Brent Futures (which is also possible to interpret widely, or could simply refer to 'Brent Crude Futures').

Q4: Are there other benchmarks that also fulfil these criteria? If so, can you provide and explanation of how and why they fill the criteria?

7. We do not consider there to be any obviously omitted benchmarks at this stage. However it could be argued that UK Gilt rates, GEMMA (Gilt-edged Market Makers Association) and GOFO (Gold Forward Offered Rates) may appear to meet the definition, so as the regulatory regime develops; a more precise definition may be required.

Q5: Are there any specific factors to consider in the listed benchmarks that need to be taken into consideration when bringing them within the scope of regulation?

8. The highlighted benchmarks have much in common, but as noted in Table 1 the way in which they are produced will need to be considered as not all benchmarks use the same methodologies or terminology. For example, we have previously engaged with oil price reporters when considering the assurance requirement regarding their adherence to the IOSCO Principles for Oil Price Reporting Agencies[2] and found wide differences in way that benchmark producers collected data and interacted with providers of that information. The term "submitters", for example, is more applicable in interest rate benchmarks than other types of index, and there is even sensitivity over the term "benchmark".

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[1] *Assurance Reports on Benchmarks and Indices* http://www.icaew.com/~/media/Files/Technical/technical-releases/financial-services/tech02-14fsf-assurance-reports-on-benchmarks.pdf

[2] *IOSCO Principles for Oil Price Reporting Agencies:* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD391.pdf

9. ICE as an organisation appears to be an increasingly key and influential role in UK benchmarks being responsible for three of the eight proposed benchmarks, including LIBOR. We would encourage regulators and legislators to consider carefully whether concentration of a number of significant benchmarks with any one administrator poses any risks or requires any changes to the approach to dealing with, or overseeing, that administrator.

Q6: Do you agree that these are the areas where costs will arise?

We agree that the listed areas are broadly those where costs will arise. We would encourage the review not to underestimate the investment required by administrators and submitters or other regulated contributors to the creation, enhancement and on-going monitoring and improvement of their systems and controls. The benchmarks considered significant by the review fall within different lines of business and therefore there are likely to be different systems, processes, controls and people, so in some cases there may be limited leverage from LIBOR learnings.

10. The cost associated with external assurance (audit) is subject to a number of variables and we would be pleased further input into the most effective and efficient way of structuring any required assurance so as to provide appropriate cost benefit to key stakeholders. These costs may be a relatively small part of the overall cost of implementing new systems, processes and controls. Clarity will be needed around the expectations of key stakeholders with regard to assurance, and where it creates the most value.

Q7: Do you agree that these are major expected benefits?

11. We largely agree with the expected benefits as articulated, but would characterise the first three as outcomes which would naturally follow the implementation of regulation with regard to the named benchmarks, and the latter three would be the benefits of those outcomes. Improved resilience, reduced risk of misconduct and increased governance and regulatory oversight should naturally lead to increased credibility and integrity. These will in turn enhance the reputation of banks, both within the industry and in the public eye.

12. With regard to the fourth point 'decreased likelihood of cessation of these key benchmarks' it should be noted that, since benchmarks have started to be regulated, the costs of producing benchmarks have increased, a number of organisations have stopped submitting data to certain benchmarks, and indeed some benchmarks have been withdrawn. Whilst benchmarks and indices are a fundamental part of the working of many markets and their operation is important for the smooth running and confidence of markets, not all stakeholders will necessarily see them as a 'public good' which they have a duty to contribute to without some form of compensation. It may therefore mean that the future business model of benchmarks may have to change to ensure they remain an economic proposition for those who contribute to them, for example, increasing use of subscription based services.

Q8: How can costs and benefits best be quantified?

13. There should be existing data from organisations which have applied the IOSCO Principles for Financial Benchmarks[3] and enhanced their controls and processes accordingly. These costs may vary (sometimes greatly) depending upon the nature of the benchmark submitter or administrator, as demonstrated by the investment required by oil price reporting agencies in applying the IOSCO Principles for Oil Price Reporting Agencies.

14. Some of the benefits which will arise from the implementation of the review may not be sufficiently tangible to observe over the short to medium term, as such a longer terms view of how they may best be quantified might be required. It would be possible to characterise the avoidance of regulatory fines as a benefit (which have amounted to billions, and continue to grow).

[3] *IOSCO Principles for Financial Benchmarks – Final Report:* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf