



EUROPEAN CENTRAL BANK

EUROSYSTEM

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Review of the latest reforms regarding financial benchmarks

FXCG meeting in Frankfurt
24 October 2013

Overview

- 1 Vulnerabilities/scandals relating to financial benchmarks
- 2 Main reform processes
- 3 Overview of draft EC Regulation on financial benchmarks

Recap of recent scandals

Interest rate benchmarks

- 2008/2009: Allegations **of manipulation of key interest reference rates**
- **Libor scandal in 2012:**
 - Fraudulent actions
 - Banks falsely quoted LIBOR contributions: aim:
 - profiting from trades
 - improving impression of creditworthiness
 - Considerable fines: up to now: a total of more than \$2.6 bn for 3 banks and 1 non-bank

FX benchmarks

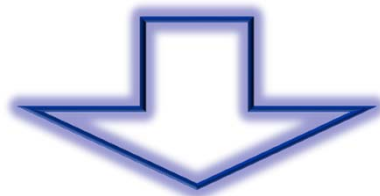
- Investigations into alleged manipulation of FX reference rates (e.g. WM-Reuters FX fix)

Energy benchmarks

- Probes into oil, gas and biofuel markets

Implications

- Market distortion: 1,000 trillion of financial instruments and contracts referenced by benchmarks
- Market integrity and credibility of reference rates at risk
- Implications for monetary policy and financial stability
- Harm investors and consumers and potentially distort real economy



Comprehensive review of the governance of benchmark processes

- Reduce risk of manipulation
- Robust, reliable and representative

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Approaches to reform

- **BIS report on the role of central banks in the use and production of reference rates** (Mar 2013)
 - “Towards better reference rate practice: A central bank perspective”
- **IOSCO’s principles for financial benchmarks** (Jul 2013)
 - Set of international principles on which the national regimes can be based
 - Aim: to enhance the integrity, reliability and oversight of benchmarks
 - Scope: establishing guidelines concerning governance, quality, methodology and accountability for benchmark administrators and other relevant bodies
- **Financial Stability Board (FSB) work on financial benchmarks:**
 - G20 requested to improve oversight and governance framework
 - Official Sector Steering Group (OSSG) of regulators and central banks to coordinate benchmark reforms with initial focus on interest rates
 - OSSG supported by a Market Participants Group examining feasibility of adopting additional reference rates and proposing strategies for any transition to new reference rates

Specific initiatives in Europe

- **UK Treasury's Wheatley Review of Libor** (Sep 2012)
 - Administration of Libor now regulated by FCA
 - Manipulations became a criminal offence
- **ESMA-EBA principles for benchmarks** (Jun 2013)
 - Guidance in the interim period before a legislative regime of the Commission comes into force
 - Applicable to submitters, administrators and users of benchmarks
- **EU amendments to Market abuse legislations** (Sep 2013)
 - Manipulation and abuse of benchmark setting become subject to administrative and criminal sanctions
- **EC's draft Regulation on financial benchmarks** (Sep 2013)
- **ECB acting as catalyst for private sector initiative of Euribor-EBF** (Feb 2013 to now)
 - Analyse feasibility of transaction based unsecured euro money market reference rate
 - Collection of transaction data from about 60 banks

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The main new elements of the EC Regulation

- **Benchmark providers to be regulated and supervised**, regulated contributors (e.g. as financial institutions) to be supervised;
 - **Conflicts of interest** to be managed;
 - Providers of benchmarks and contributors to benchmarks: ensure **appropriate governance and controls over the benchmark-setting process**;
 - **Methodologies to be transparent and robust** and use sufficient, accurate and representative underlying data;
 - Improved **transparency** of the benchmark-setting process;
 - **Suitability assessment** of benchmarks for retail contracts
- Proposal covers administration, supervision, contribution and use of benchmarks within the EU

EC Regulation: What is a benchmark?

- An **index** is any figure
 - published or made available to the public
 - regularly determined by a calculation or assessment
 - on the basis of underlying assets, values or prices
- A **benchmark** is an index used as a reference price
 - for financial instruments e.g. derivatives
 - for financial contracts e.g. mortgages
 - to measure the performance of an investment fund e.g. UCITS

Authorisation and supervision

- Authorisation and supervision regime for administrators
- Entities already regulated will be supervised for the activity of contributing to benchmarks
- Supervision by national competent authorities
- Administrative measures and sanctions for breaches of the Regulation

Methodology and Input data

- **Data:**
 - Sufficient and accurate
 - **Transactions data** used where possible, estimates if verifiable.
- **Methodology**
 - Robust and reliable methodology
 - Representative contributors
- **Transparency:**
 - develop, operate and administer benchmark methodology transparently
- **Reporting of breaches:**
 - requirement to monitor input data and report identified manipulations

Critical benchmarks

Specific requirements for critical benchmarks in view of their significant importance in the financial system

- Critical benchmarks
 - Reference of financial instruments more than EUR 500 bn of notional volume
 - Majority of supervised contributors
- Commission determines critical benchmarks through a decision
- Mandatory contributions possible
- College of supervisors ensures the exchange of information and a coordinated approach to their supervision

Draft EC Regulation on financial benchmarks

Next steps

- The EC draft Regulation needs to be considered and adopted by the European Parliament and the Council in the ordinary legislative procedure before becoming law
- The EC expects this process to be completed by the end of this parliamentary mandate (spring 2014) and the rules to come into effect one year later (2015)



Thank you for your attention!