Submission by ICIS in response to *Financial Benchmarks Regulatory Reform* a Consultation Paper by the Council of Financial Regulators.

General Comments on Sections 1

We fully support the CFR's objective that all obligations placed on benchmark administrators should be consistent with the benchmark principles developed by IOSCO.

We would ask CFR to keep in mind that there are two sets of IOSCO principles for benchmarks:

1. *The Principles for Oil Price Reporting Agencies* published in October 2012; and
2. *The Principles for Financial Benchmarks* published in July 2013.

Although the *Principles for Financial Benchmarks* drew much of their inspiration from the earlier PRA Principles, they were never intended to replace them. Instead, IOSCO was at pains to emphasise that the *PRA Principles,* which took account of the specific characteristics of commodity markets and of PRAs as media publishers, remain the appropriate set of principles for PRA benchmarks

These two sets of IOSCO principles together form the IOSCO principles for benchmarks, and not only IOSCO's *Principles for Financial Benchmarks* as paragraph (a) on page 1 of the Consultation Paper suggests.

However, we do of course recognise that IOSCO's *Principles for Financial Benchmarks* are the relevant set of IOSCO principles for the particular benchmarks that the CFR is now considering bringing into regulation.

General Comments on Section 2

The second last paragraph on page 2 of the CP reads as follows:

> *"The second risk arises in part because of the extra-territorial impacts of, most notably, the EU's proposed benchmark regulation. The EU regulation will require EU-based financial institutions to only use benchmarks that comply with EU regulation or otherwise comply with the regulation's third country benchmark recognition regime."*

It may be worth clarifying that although the proposed EU regulation has broad extra-territorial impacts, its scope is in fact limited to the use of a benchmark by EU-based financial institutions <u>for the purposes of trading on an EU trading venue.</u> The Benchmark Regulation does not extend to benchmarks used for trading on third country trading venues. This has been confirmed by a European Commission "non-paper" circulated in Q4 last year:

> *"The [Benchmark] Regulation only applies to indices which are used in financial instruments for which an admission to trading has been made or that are already trading on EU venues." ("Commission Services non-paper: Commodity benchmarks")*

The EU Regulation would not regulate an EU-based financial institution in its use of a benchmark for trading on a third country trading venue. The Regulation's scope would, however, cover an Australian-produced benchmark that is used in a financial instrument for trading on an exchange or other trading venue established in the EU.

Secondly, the EU's Benchmark Regulation defines "*use of a benchmark*" quite narrowly (see Article 3.1(7) and the final sentence of Recital 13).

General Comments on Section 3

We ask the CFR to consider establishing an additional **voluntary** regime available to any administrators of benchmarks that would not be brought into regulation under the CFR's proposals. Such an administrator would have the option to submit their benchmarks to oversight under an IOSCO-compliant regime. The administrator would be required to demonstrate compliance with points (a), (b) and (c) on page 6 of the CP.

We recall that the Monetary Authority of Singapore (MAS) raised the option of a voluntary registration regime for benchmark administrators "*so as to facilitate them to continue their Singapore operations*." *("Consultation Paper on Proposed Amendments to the Securities and Futures Act on the Regulation of Financial Benchmarks*. July 2014" paragraph 16).

In our view, the MAS idea has considerable merit. A voluntary regime of this kind would have three clear advantages:

1. It would provide a means by which a benchmark administrator would be able to demonstrate to markets, its users and its contributors that its benchmarks are produced in accordance with international best practice. This should, in turn, reinforce confidence in the integrity of markets.
2. It would establish a mechanism through which a greater number of administrators could continue to supply their benchmarks out of Australia for use in third country jurisdictions. In the case of the EU's Benchmark Regulation, the option would directly respond to the partial equivalence regime set out in Article 30(3); and
3. A larger number of benchmark administrators would become IOSCO-compliant. For example, once one administrator had taken forward this option, it is likely that its competitors would follow suit in order to remain competitive.

We would therefore urge Australia to take an international leadership role in establishing a supervisory framework to accommodate the voluntary submission by benchmark administrators to IOSCO-compliant oversight.

General Comments on Section 4.1

We support the regulatory objective of establishing a "*binding framework which effectively embeds compliance with the IOSCO Principles as requirements of domestic law,"* rather than developing an '*Australian-tailored'* set of benchmark administration requirements.

As we have made clear in our covering email, ICIS has the highest regard for IOSCO's benchmark workstreams. We are also pleased at IOSCO's positive conclusion last September that:

> *"the PRAs have made the PRA Principles an integral part of their management policies and operational practices." (*IOSCO's *Second Implementation Review of PRA Principles"* page 12)

Although the proposed EU Benchmark Regulation expressly acknowledges in its recitals and elsewhere that the two sets of IOSCO benchmark principles establish the "*global standard*" for

benchmarks, some aspects of the Benchmark Regulation directly contradict them and, as a result, will undermine international standardisation around IOSCO's benchmark principles. Moreover, the EU regulation, consisting of Level 1 and Level II texts, is a most complex construct. By contrast, the CFR's limited and focussed objective of embedding the IOSCO benchmark principles into law is greatly preferable.

We support requirements (a), (b) and (c) proposed on page 6, which we agree should meet the conditions of the Third Country approach taken by the EU Benchmark Regulation.

Response to Question 6: *Is there another option you prefer*?

As we have explained in our comments on Section 4.1, we support the CFR's regulatory objective of establishing a "*binding framework which effectively embeds compliance with the IOSCO Principles as requirements of domestic law,"*

However, we believe it may be worth the CFR also considering the specific "*Mechanisms for Implementation"* suggested by IOSCO in its PRA Principles (page 8). The second "mechanism" proposes:

> *The use by a market authority of its rule approval and/or review authority over derivatives contracts, as appropriate, to refuse admission to exchange trading or central clearing of any oil derivatives contract that references a PRA-assessed price which, in the opinion of the market authority, has been developed under policies and procedures that do not reflect effective implementation of the PRA principles and call into question the reliability of an assessment.*
>
> *In this regard, IOSCO recommends that market authorities consider whether to prohibit trading in any commodity derivatives contract that references a PRA-assessed price unless that assessment follows the IOSCO PRA Principles."*

In its Report on Implementation of the PRA Principles last September IOSCO recorded--on the basis of information supplied by the PRAs--that

> *"exchanges in the US, UK and Singapore are requiring a successful assurance review or audit either before listing a physical commodity derivative contract or shortly thereafter."*(Page 12)

Our experience is that the *Mechanisms for Implementation* proposed by IOSCO are working very effectively. For example, we are aware of non-IOSCO compliant benchmarks having to be replaced by compliant benchmarks.

Accordingly, we commend the *Mechanisms* to the CFR and suggest that they might be applied more widely to any benchmarks referenced by derivatives contracts. In other words, a market authority would refuse admission to exchange trading or central clearing of any contract that references a benchmark unless it is compliant with IOSCO's *Financial Benchmark Principles* or *PRA Principles*, whichever is appropriate.

We believe that placing these obligations on the market authority could be more practical than seeking to impose direct regulation over individual benchmark administrators, as well as equally effective, particularly should Australia ever consider broadening the scope of benchmark regulation in the future.

General Comments on Section 5

Although it will not be relevant to any of the specific benchmarks that the CFR is now considering bringing within regulation, we would ask the CFR to keep in mind that one of the most important differences between the two sets of IOSCO benchmark principles is their distinctive approaches towards contributors. In its Final Report on the PRA Principles IOSCO issued specific warnings about the impracticalities, as well as the risks, of attempting to impose regulation or obligations on contributors to PRA benchmarks (IOSCO PRA Principles p 8).

UK Energy regulator Ofgem expressed similar concerns in its "*Pricing benchmarks in gas and electricity markets—a call for evidence"* published in June 2013:

> *"..some types of regulation may introduce risks to the process. In particular, greater regulatory scrutiny of the information flows could introduce a perception of risk (irrespective of whether the risk is real) to those providing the information. Regulation should increase the quality of information provided, but could reduce the willingness of parties to provide it. Information is provided on a voluntary basis and the simplest way to mitigate this risk may be to withdraw cooperation and decline to provide it. This is turn may lead to a breakdown in the quality of the price assessment process, with negative consequences for the market and consumers."*

Many commodity markets are global with the result that there will be practical and jurisdictional constraints on imposing regulation on benchmark submitters that are located in third countries. Another constraint in energy and some other commodity markets is that contributors are frequently sovereign—or state-connected-- enterprises.

But once again, **any** attempts to impose legal obligations on voluntary contributors in energy and other commodity markets run the risk of causing contributions to dry up, so undermining benchmark integrity.

Response to Question 14: *Do you have any comment on the proposal to introduce a specific offence of benchmark manipulation?*

We welcome the CFR's proposal to introduce a new specific offence of benchmark manipulation. We also support the recommendation to extend its scope to **al**l financial benchmarks, and not just to those benchmarks that will be brought under regulation. In our view, criminalising benchmark manipulation is (by far) the most effective means of upholding the integrity of benchmarks

Response to Question 16(b): *Do you have any comment on the fault elements of the proposed offence?*

We wish to emphasise the need to take particular care to calibrate the offence of benchmark manipulation to ensure that it will not deter market participants from continuing to make the voluntary contributions of price and other information on which the integrity of many benchmarks depends.

The danger that regulatory intervention may result in *“market participants decreasing or even ceasing their [voluntary] submission of data”* was highlighted by IOSCO in its PRA Principles and also by Ofgem, as we have already referred to in our comments on Section 5.

In order to avoid the risks that IOSCO, Ofgem and others have highlighted, we urge the CFR to ensure that the final legislation makes it abundantly clear that errors made in good faith would not be punished. The CFR refers to the “*knew or ought to have known*” precedents in UK and EU legislation, but our preference is for the US approach. The Dodd Frank Act provides as follows:

> *‘(C) GOOD FAITH MISTAKES.—Mistakenly transmitting, in good faith, false or misleading or inaccurate information to a price reporting service would not be sufficient to violate subsection (c)(1)(A).”* [Dodd-Frank Act Section 753]

We recall that the US has been extremely active in taking enforcement action against benchmark manipulation and we note its success has not been constrained by there being a particularly simple and clear exempting provision for “*good faith mistakes*”.

(END)