

HM Treasury
Benchmarks consultation
Financial Services Group
1 Horse Guards Road
London SW1A 2HQ

23 October 2014

Dear Ashleigh Brigden

HM Treasury Fair and Effective Markets Review Recommendations on Benchmarks – FIA Europe Response

We attach our response to the eight questions raised in the HM Treasury Fair and Effective Markets Review Recommendations consultation on Benchmarks. In summary:

- HM Treasury acting unilaterally in the UK: risks causing a fragmentation of liquidity and market disruption; could actively harm competition and choice; and could result in an uneven playing field across Europe.
- HM Treasury is encouraged to await the outcome of current discussions at a European level on the regulation of benchmarks in order to avoid duplication of efforts as new UK specific regulation will be superseded by new EU legislation.
- We do not consider that ICE Brent Futures meets criterion 3, *“Benchmarks that are based on transactions in financial instruments which are not covered comprehensively by existing market abuse regulation.”* Market convention is for Over-the-Counter (“OTC”) Brent contracts to reference the daily settlement price of the future, which is derived from trading activity during a two minute period in the trading day. This contract is already governed by the ICE Futures Europe rulebook, the Financial Services and Markets Act (“FSMA”) and the Market Abuse Directive (“MAD”). Clarity should be provided as to whether the ICE Brent Index is actually the recommended benchmark.
- If the recommended benchmark is the ICE Brent Index, considering market convention is to reference the futures price, the Index may not meet criterion 1, *“Benchmarks that are major FICC benchmarks.”* The Index is used for counterparties electing, in an alternative to physical delivery, to cash settle open ICE Brent Futures positions at contract expiry. ICE Brent Futures’ open interest diminishes significantly towards contract expiry, thereby reducing the positions available for cash settlement against the Index.
- The ICE Brent Index calculation comprises an average of assessed values and traded prices in the forward 25-Day Brent, Forties, Oseberg and Ekofisk (“BFOE”) market drawn from price reporting agencies. It is not clear if HM Treasury determines this method to be submission based. Consequently it is not clear who will be deemed to be a submitter for the benchmark purposes.
- Potential departure from the IOSCO principles on Benchmarks: HM Treasury’s focus appears to be on the physical market, however, IOSCO’s report on Implementation of the Principles for Oil Price Reporting Agencies (“PRA”) stated that it was comfortable that the four main oil PRAs (which would include Platts for Dated Brent) had made good progress towards implementing its requirements.
- A number of the proposed benchmarks are derived from traded activity by the independent action of the benchmark administrator. The regime needs to be tailored to ensure that the full obligations of a ‘Submitter’ are not imposed upon a participant whose only action is to trade in the ‘normal course of business’.
- Three of the seven benchmarks in the review are currently being modified. Consideration should be given to whether it would be more suitable to check if these 3 benchmarks meet the published criteria, only once these modifications are complete.

We thank HM Treasury for their pro-active engagement with the industry during this important consultation, and welcome any opportunity to discuss these concerns further with you.

With kind regards,

A handwritten signature in black ink, appearing to read 'S. Puleston Jones'.

Simon Puleston Jones
(CEO, FIA Europe)

Response to Consultation Questions

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

Yes.

2. **Are there other criteria that should also be included?**

No.

3. **Do the benchmarks meet the criteria?**

The benchmarks (other than the Ice Brent Futures which fails to meet criterion 3) broadly meet the established criteria; however we would like to point out the following:

- **ICE Brent Futures:** The inclusion of ICE Brent Futures as a benchmark has raised several concerns due to the nature of the contract itself. It also raised questions as to:
 - I. The scope of the regulation
 - II. The selection of various benchmarks
 - III. The scope for inclusion of other futures contracts in the list of benchmarks.

The review has recommended "ICE Brent" be made both a "specified benchmark" and a "relevant benchmark" to ensure that both FSMA and criminal sanctions are available.

The review provides a description of "ICE Brent" as a futures contract which settles in cash against an index using the price of physical cargoes of crude oil from BFOE."

Other futures contracts with price linkage to in-scope benchmarks have been excluded, having been deemed to not fulfil criterion 3. For example, some of the leading global benchmarks in the base metals market are based on the price of traded futures. However, these benchmarks are determined as the price of futures contracts traded on a 'prescribed' market already covered by market abuse legislation. The Review has therefore concluded that the benchmark does not meet the criteria for inclusion. For the same reason ICE Brent Futures should be deemed not to meet criterion 3, because it is already governed by ICE Futures Europe rulebook, FSMA and MAD. As above, the Brent Index price used to cash settle all futures contracts remaining open at expiry is not a significant benchmark for the purposes of OTC markets.

The Index itself is a reflection of activity in the BFOE market as reported by the media.

- **ISDAFIX:** Whilst the ISDAFIX benchmark currently meets the criteria, it will shortly change from a survey/poll-based benchmark to a tradable quote-based benchmark. This event will necessitate its re-classification as potentially out of scope. Where there is a change in benchmarks there is a need for procedures that periodically determine whether a given benchmark becomes or remains subject to proposed regulation. In light of the modifications being made with ISDAFIX, we consider that benchmarks should be subject to assessment by reference to criteria post modification only.
- **SONIA / RONIA / WMR:** These benchmarks are transaction based, which we consider could be adequately covered by existing market abuse legislation.
- **LBMA Silver Price / London Gold Fix:** Some doubts have been expressed as to the classification of Silver Price as a major benchmark for FICC. In addition, both Silver and Gold Fixes are transaction based benchmarks, and both are currently undergoing a transformation. We therefore ask HM Treasury to consider whether it is appropriate to classify them until their transformation is complete (expected end December 2014).

4. Are there other benchmarks that also fulfil these criteria? If so, can you provide an explanation of how and why they fulfil the criteria?

We have not identified any other benchmarks that meet the criteria.

5. 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?

Existing Market Abuse Regulation Applicable to the Benchmark: ICE Brent Futures are contracts already highly governed by the ICE Futures Europe Rulebook and regulations such as FSMA and MAD.

Existence of Submitters: SONIA / RONIA / WMR prices are not determined by reference to a price submission process instead they are all based upon traded activity. In addition, the ISDAFIX benchmark will soon move to a tradable based benchmark. It is therefore unclear as to who qualifies as a 'Submitter' under this regulation in these instances. The proposals impose substantial obligations on 'Submitters' and these should be distinguished from market participants whose only action is to trade an instrument 'in the normal course of business', that through the independent action of the benchmark administrator, becomes a benchmark. The specifics of the benchmark price discovery mechanisms and the relating obligations that apply need to be tailored for each benchmark.

ICE Brent Futures: ICE Brent Futures contract is traded, and the price is derived on a daily basis in the same manner as other futures contracts. The daily settlement price of the ICE Brent Futures contract is derived by calculating the weighted average price of **traded futures contracts**, during a two minute settlement period from 19:28:00, (LDN time). A common method for determining the daily settlement of exchange traded futures contracts. It is the daily settlement price as calculated by the exchange that forms the prime benchmark reference price for the OTC market.

If the contract is not delivered via the Exchange for physical mechanism, there is an option to cash settle the value of the ICE Brent futures contract against the ICE Brent Index price for the last trading day of the futures contract. (The Brent Index Price provides the basis for which the futures contract cash settles at expiry).

The ICE Brent Index: The ICE Brent Index price represents the average price of trading in the 25-day BFOE market in the relevant delivery month as reported and confirmed by the industry media. ICE calculates the Index based on its own methodology. The media agencies from this assessed and traded data is currently not made public by ICE. The exchange acts as an aggregator of available market-related data.

Based on the above FIA Europe believes that the ICE Brent Futures contract does not meet the selection criteria and the rationale provided for its inclusion in the recommendation list.

6. Do you agree that these are the areas where costs will arise?

Yes. These costs would be substantial and could result in today's benchmark submitters and administrators choosing to exit the business. It is not clear who would replace them.

This could lead to a concentration of risk in a few institutions who remain involved in the relevant benchmarks. FIA Europe and its members would encourage the regulators to consider the cost of compliance in this regard and also to consider that UK regulation will be superseded by the future European benchmark regime.

We query the benefits of the UK imposing a regime unilaterally given it is known that European regulations in the event of any conflict are already being discussed and negotiated in this area and will ultimately supersede any UK initiatives.

We consider the proposed extension in scope of the UK regime ahead of the EU Benchmarks Regulations could result in a fragmentation of liquidity and potential market disruption.

7. Do you agree that these are major expected benefits?

Yes, but for reasons outlined above, HM Treasury is encouraged to consider:

- **Increase in Likelihood of Cessation of these Key Benchmarks:** There is the risk that the costs and regulation may drive submitters out, and consequently there would be significant concentration risk to few submitters or the risk that those submitters would pull out altogether.
- **Greater Confidence in Financial Markets:** Some members have commented that there could be a greater focus on strengthening the framework around the underlying markets through existing regulation.

8. How can costs and benefits best be quantified?

Unfortunately we have not had the opportunity to obtain this data from our members during this consultation.