



HM Treasury

# **Implementing the Fair and Effective Markets Review's recommendations on financial benchmarks:**

**response to the consultation**

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# Contents

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		Page
Chapter 1	Introduction	3
Chapter 2	Criteria	5
Chapter 3	Benchmark recommendations	7
Chapter 4	Costs and benefits	11
Annex A	List of respondents	13



# 1 Introduction

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## Background

**1.1** The government is committed to raising standards of conduct in the financial system. On 12 June 2014, the government announced the establishment of the Fair and Effective Markets Review, led by the Bank of England Deputy Governor for Markets and Banking, Minouche Shafik, with Martin Wheatley (Chief Executive Officer, Financial Conduct Authority (FCA)) and Charles Roxburgh (Director General Financial Services, HM Treasury) as co-chairs.<sup>1</sup>

**1.2** The review will publish its final report in June 2015, and recently published its consultation document entitled *How fair and effective are the fixed income, foreign exchange and commodities markets?*<sup>2</sup> However, as a near-term interim output, the Chancellor of the Exchequer asked the review to recommend a list of additional major benchmarks across the Fixed Income, Currency and Commodities (FICC) markets that should be brought into the regulatory framework originally implemented in the wake of the LIBOR misconduct scandal. The review reported to HM Treasury on its recommendations on 29 August 2014.

**1.3** The government published a consultation document on these recommendations on 25 September 2014.<sup>3</sup> This invited responses on the review's criteria, on its recommendations of which major benchmarks should be brought into the UK regulatory perimeter, and on the potential costs and benefits of these changes. This consultation closed on 23 October 2014.

**1.4** The government received over 20 written submissions to its consultation, including from trade bodies, benchmark administrators, banks and other relevant industry representatives. The government also hosted target industry roundtables for representatives of affected parties. A full list of those who responded to the consultation is at annex A.

**1.5** This document summarises the submissions received in answer to the consultation questions, and sets out the government's response. The government is grateful for all of the contributions made by stakeholders during the consultation process.

## Key themes

**1.6** There was general agreement with the approach set out in the fair and effective markets review's report to HM Treasury, and the government welcomes this support from stakeholders. Responses to the criteria used by the review focused primarily on how best to define what is meant by a "major" benchmark as one of the 3 criterion. Further details about the consultation responses received on the review's criteria, and the government's response, are set out in chapter 2.

**1.7** Overall, respondents agreed that the 7 benchmarks recommended by the review did meet the review's criteria, and that these should be brought into the UK regulatory regime. Several respondents raised questions about whether the Repurchase Overnight Index Average (RONIA) and the LBMA Silver Price benchmark met the review's criteria. More broadly, 3 messages were raised in the consultation. The first was that respondents highlighted the need to consider the reforms currently underway for a number of benchmarks recommended by the review. Second,

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<sup>1</sup> The terms of reference for the review are set out on the Bank of England's website at [www.bankofengland.co.uk/markets/Pages/fmreview.aspx](http://www.bankofengland.co.uk/markets/Pages/fmreview.aspx)

<sup>2</sup> <http://www.bankofengland.co.uk/markets/Documents/femr/consultation271014.pdf>

<sup>3</sup> <https://www.gov.uk/government/consultations/fair-and-effective-market-reviews-benchmarks-to-bring-into-uk-regulatory-scope/implementation-of-the-fair-and-effective-market-reviews-recommendations-on-benchmarks-to-bring-into-uk-regulatory-scope>

respondents raised the need to consider wider international and European reforms in train. Finally, stakeholders suggested that it was important to acknowledge the difference between a market participant and submitter to a benchmark. Further details on responses received on the review's recommended benchmarks to be brought into the UK regulatory regime, and the government's approach in response, are set out in chapter 3.

**1.8** The government's consultation also sought views on the likely costs and benefits of implementing the review's recommendations. Respondents largely agreed with the approach for analysing the costs and benefits as set out in the consultation document, with costs falling on regulators, administrators and submitters. Further details on responses from stakeholders on this point, together with the government's approach, are set out in chapter 4, and in the impact assessment.

**1.9** Having carefully considered both the written responses to the consultation, and the responses made at industry roundtables for representatives of affected parties, the government's view is that all 7 benchmarks recommended by the review be brought into the UK regulatory regime. The only changes to the review's recommendations are to ensure that developments in the London Gold Fixing are reflected in the draft legislation, and that the ICE Brent Index is named as the regulated benchmark rather than the ICE Brent Futures price.

## **Next steps**

**1.10** It is the government's intention to lay the necessary legislation early in 2015, so that the proposed legislative changes can be debated before Parliament. A revised statutory instrument is published alongside this consultation response. Ahead of the legislation commencing, the FCA will consult on their draft rules, and then publish final rules. The government intends for the legislation to commence on 1 April 2015.



## 2 Criteria

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**2.1** In order to identify a shortlist of benchmarks, the review developed 3 criteria which benchmarks had to meet in order to be recommended for inclusion in the UK regime. These were:

- benchmarks that are major FICC benchmarks, defined as those which have the greatest usage within the main FICC product markets. It is these benchmarks that would have the biggest impact on retail and wholesale investors if they were distorted or abused;
- benchmarks where the main benchmark administration activities are located in the UK, due to the appropriateness and limits of legislative reach; and
- benchmarks that are based on transactions in financial instruments which are not covered comprehensively by existing market abuse regulation.

### Summary of responses

**2.2** The majority of respondents agreed the criteria set out in the review's recommendations were appropriate, and that no further criteria should be included. A few respondents highlighted that the criterion of "major" benchmarks could be more specific, and that further clarification would be helpful to quantify what was meant by major, with one respondent seeking a quantitative methodology for identifying benchmarks. The same respondent highlighted that an "exit guide" would also be helpful, to identify where and when benchmarks may fall out of the regulatory regime. One respondent highlighted that, as presented in the review's recommendations, the third criterion would exclude certain commodity benchmarks, and that this should be amended to take into account trades in physical commodities that underlie commodity benchmarks. A few respondents highlighted that these criteria should coincide with the "critical" benchmark category in the European Commission's proposal for a regulation on benchmarks.

**2.3** Several other potential criteria were suggested by respondents. These further criteria included: the benchmark's vulnerability to manipulation; the effect of the benchmark itself; and the consideration about who owns the benchmark and whether they have a vested interest.

**2.4** One respondent put forward an alternative methodology, including both quantitative and qualitative criteria. These included: the number of trading/market making participants; the estimated size of the user base; the tenor of product life; the size of dependent derivatives market; whether the benchmarks were for wholesale or retail use; the impact on the government's competition objectives; and whether EU legislation was forthcoming.

### Government response

**2.5** The government welcomes the support for the fair and effective markets review's approach, and the criteria used in their recommendations. There are a wider variety of benchmarks across Fixed Income, Currency and Commodity markets that could potentially have been included, and the government welcomes the review's proportionate approach. The review examined a number of indicators in drawing up their assessment of whether these benchmarks are major, such as the number and value of financial contracts directly or indirectly linked to the benchmark, the range of different usages and the degree of market recognition, as it is these that would have the biggest impact on retail and wholesale investors if their integrity were questioned. Whilst the government recognises that a level of judgment is required in assessing whether benchmarks are

major, the government's view is that the 3 criteria put forward by the review are appropriate, and best identifies those benchmarks with the greatest importance for the UK's financial system.

**2.6** The government does not feel that it would be appropriate for the criteria here to coincide with the "critical" benchmark category in the European Commission's proposal. One important reason for this is that the category as set out in the EU proposal is subject to change through the ongoing negotiation process in the European Parliament and Council, meaning that attempting to have the criteria suggested by the review coincide with that in the EU proposal would be difficult given the difference in timing.

# Benchmark

## 3 recommendations

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**3.1** Using its selection criteria, the review narrowed down its recommendations to 7 benchmarks:

- Sterling Overnight Index Average (SONIA)
- Repurchase Overnight Index Average (RONIA)
- WM/Reuters (WMR) 4pm London Closing Spot Rate
- ISDAFIX
- London Gold Fixing benchmark
- LBMA Silver Price
- ICE Brent

**3.2** The government's consultation asked whether these benchmarks met the criteria set out by the review, whether there were other benchmarks that also fulfil these criteria, and whether there were any specific factors of the listed benchmarks that needed to be taken into consideration when bringing them into the scope of regulation.

### Summary of responses

**3.3** The majority of respondents agreed that the 7 benchmarks highlighted by the review did satisfy the criteria identified in their report. However, several respondents suggested that some benchmarks did not fully satisfy all three criteria set out by the review, particularly around whether a benchmark was "major" or not.

**3.4** One respondent highlighted that RONIA did not satisfy the criteria, as it represents a much smaller share of the notional value of Sterling overnight index swap portfolios than SONIA. Another respondent noted that further data was needed to support the review's recommendation that RONIA is a major benchmark.

**3.5** Several respondents suggested that the LBMA Silver Price did not constitute a major benchmark due to the relatively small volumes of silver traded, particularly when compared to the gold market. One respondent noted that the inclusion of silver implied that other benchmarks of a similar magnitude, including other precious metals, should also be brought into the regulatory perimeter.

**3.6** Several respondents sought clarification on whether the consultation asked for views on extending the regulatory perimeter to the ICE Brent Futures Index or the ICE Brent Index. It was argued that existing regulation, particularly the market abuse provisions of the Financial Services and Markets Act (FSMA) 2000, already covered abuse in the futures market. One respondent also suggested that the ICE Brent Futures Index is dependent on submitters from outside the UK, and so did not meet all three criteria.

**3.7** A few respondents sought clarity on the number of benchmarks that were to be brought into the regulatory regime. For example it was noted that there are a total of 160 WM/Reuters FX benchmarks and 60 ISDAFix benchmarks, and so respondents asked whether only the most liquid or important benchmarks would be brought in.

**3.8** The consultation also asked whether there were other benchmarks that also fulfilled the criteria set out by the review. The majority of respondents did not propose any further benchmarks. However, a few respondents suggested that the Gilt Edged Market Makers Association (GEMMA) reference prices, published by the UK Debt Management Office, and the Gold Offered Forward Rate, could also be brought into scope. Another respondent recommended that, although there were probably other benchmarks that satisfy the criteria, the government should focus on these seven benchmarks first.

**3.9** The consultation also asked whether there were any specific factors to consider when bringing the recommended benchmarks within the regulatory perimeter. Several respondents highlighted the importance of considering reforms currently underway for a number of the recommended benchmarks, particularly ISDAFix, the LBMA Silver Price and the London Gold Fix. Respondents also suggested that it was important to consider other regulatory reforms, particularly given negotiations on EU Benchmarks regulation and work underway to implement the IOSCO Principles.

**3.10** Several respondents highlighted the importance of recognising the difference between a market participant and a submitter to a benchmark. For example, one respondent noted that the WM/Reuters benchmark is based on actual trades, with the underlying data captured from platform operators. Given this, it was suggested that platform operators should be responsible for monitoring the data.

## Government response

**3.11** The government is grateful for the level of response to its consultation on the review's recommendations about which benchmarks should be brought into the UK's regulatory regime.

**3.12** The government notes the responses to the consultation about whether the Repurchase Overnight Index Average (RONIA) should be brought into the regulatory regime. Whilst RONIA is a relatively new benchmark, the government believes that its uniqueness as the leading indicator of secured overnight lending, and the importance that this market has for wider financial stability, justifies its inclusion in the regulatory regime.

**3.13** The review recommended that the two leading precious metal benchmarks – the LBMA Silver Price and the London Gold Fixing – met all three criteria for inclusion. It did however note that there were ongoing developments in the London Gold Fixing, and that regulatory changes would need to be tailored to the emerging future benchmark. On 7 November 2014 the London Bullion Market Association (LBMA) announced that ICE Benchmark Administration (IBA) had been selected to be the third-party administrator for London Gold Fixing and that the proposed new name for the benchmark is the LBMA Gold Price. Live testing of the LBMA Gold Price is expected to go live in Q1 2015. Given these changes, the government believes it would therefore be appropriate for the London Gold Fixing to be named in legislation, along with recognition of the proposed change of name. This is reflected in the revised draft statutory instrument.

**3.14** The review recommended that the LBMA Silver Price also be included in the regulatory regime. As set out above, several respondents questioned whether this was a major benchmark. In the review's recommendations, the LBMA Silver Price was regarded as providing a key international benchmark for the pricing of a variety of transactions and products, with a number of global users. The transactions that form the basis of the benchmark are not fully captured under the scope of the UK market abuse regime. The review did highlight that the value of assets under management for European Exchange Traded Products referenced to the LBMA Silver Fix is smaller than those referenced to the London Gold Fix, at \$3.7 billion compared with \$25.7 billion. However, given the significance of the LBMA Silver Fix to a wide range of users in

the international silver market, the government's view is that the benchmark does meet the review's 3 criteria and so should be brought into the UK's regulatory regime.

**3.15** As set out above, the review recommended that the main financial benchmark relating to physical oil cargoes in the North Sea, ICE Brent, be brought into the regulatory regime. While there was broad agreement that this benchmark should be brought into the regulatory regime, a number of respondents suggested a technical amendment to the review's recommendation to use ICE Brent Index (the underlying price for ICE Brent futures) as the specific benchmark subject to regulation rather than the futures price itself. Having considered the issue further, the government can confirm that the ICE Brent Index should be the benchmark named in legislation.

**3.16** The government has considered whether other benchmarks suggested by consultation respondents should also be brought into the UK regime. However, given that there were no recommendations consistently made by a variety of respondents, the government is of the view that there is not a strong case to include other benchmarks at this time. The government will continue to monitor developments in FICC benchmarks on an ongoing basis, to ensure that the regulatory regime remains appropriate.

**3.17** The government also notes that in the medium term the EU benchmarks regulation, which is currently being negotiated, will come into effect. The regulation is expected to have a broad scope and will capture the benchmarks recommended by the review along with others.

**3.18** It is therefore the government's view that all of the 7 benchmarks recommended by the review be brought into the UK regulatory regime. The only changes to the review's recommendations are to ensure that developments in the London Gold Fixing are reflected in the draft legislation, and that ICE Brent Index is named rather than ICE Brent Futures.

**3.19** As recommended by the review, the government's approach will be that all 7 benchmarks are made both a "specified benchmark" and a "relevant benchmark" under the current UK regulatory framework. However, the regulatory framework will apply to the 7 benchmarks in different ways, reflecting the differences in their construction.

**3.20** The government understands that administrators of all 7 specified benchmarks will be carrying out the "administering activity" in Article 630 of the Regulated Activities Order which includes collecting, analysing or processing information or expressions of interest used to determine that benchmark, and must be authorised and subject to FCA rules.

**3.21** Under the framework, anyone who acts as a benchmark submitter must also be authorised and subject to FCA rules. However, those requirements are disapplied when, among other factors, that information consists solely of factual data obtained from a publicly available source. Given this, under current arrangements the government anticipates that these requirements would be applied to contributing brokers who submit brokered overnight transaction rates and volumes to the WMBA for the purpose of determining SONIA and RONIA. Under current arrangements, submitting banks who contribute mid-market swap rates to ICE Benchmark Administration for the purpose of determining ISDAFix would also be captured. However, the government notes that ICE Benchmark Administration intends to develop ISDAFix's calculation methodology to an algorithm based approach, using tradable quotes from regulated trading venues as input for the rate.

**3.22** As noted by the review, the Financial Services Act introduced a new criminal offence of manipulating a 'relevant benchmark' either by making misleading statements or by creating a false or misleading impression of the value of investments that could affect such as benchmark. The review recommended that manipulation of these benchmarks should be subject to criminal legislation, and the government can confirm that this criminal offence will apply to any person manipulating all 7 benchmarks that have been recommended by the review.



## 4 Costs and benefits

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**4.1** The Fair and Effective Markets Review was not tasked with analysing the potential costs and benefits of bringing the recommended benchmarks within the regulatory perimeter. To support this consultation response, the government has produced a regulatory impact assessment. This impact assessment has been based on the experience of the costs and benefits of bringing LIBOR into the regulatory perimeter, as well as responses to the government's consultation.

**4.2** The consultation set out the main anticipated costs and benefits expected to fall on the contributors, administrators and regulators of the named benchmarks, and sought views on these. It was noted that many firms which would be captured as submitters to the benchmarks recommended by the review were already captured as submitters to LIBOR. The costs were expected to stem from:

- regulators: authorisation and ongoing supervision
- administrators: systems and controls; oversight committee; approval (controlled functions); capital requirements; and authorisation
- submitters: IT systems; staff; external audits; and controlled functions application

**4.3** The expected benefits, as set out in the consultation document, were expected to be as follows:

- improved resilience against attempted manipulation
- reduced risk of misconduct and associated fines and/or litigation risk
- increased governance and regulatory oversight
- decreased likelihood of cessation of these key benchmarks
- increased credibility and integrity of these benchmarks
- greater confidence in financial markets

### Summary of responses

**4.4** Respondents generally agreed that these areas identified in the consultation were the main costs that would fall on regulators, administrators and submitters. Several respondents highlighted that the proposed changes would impact most on firms not already covered by the LIBOR reforms, and that these firms would not only face an incremental increase in their costs. Several respondents raised the point that these costs could discourage participation in benchmarks, which could impact on liquidity and the benchmark's credibility.

**4.5** Respondents suggested that costs would also result from additional areas such as extending surveillance capabilities, bespoke IT software solutions, external auditing and legal and regulatory costs. The potential impact on remuneration was also highlighted. It was also noted that policy design could seek to reduce these costs, for example by aligning reporting periods across regulatory regimes.

**4.6** In terms of the expected benefits, many respondents agreed with the proposed benefits as set out in the consultation document. Several respondents made the point that reduced liquidity, as a result of fewer submitters, could undermine a benchmark's integrity, and so questioned whether the reforms would lead to a decreased likelihood of cessation. However, respondents also raised that cessation of a benchmark was not necessarily a negative outcome,

particularly if it were replaced by a superior benchmark, or that a potential solution could be for regulators to mandate benchmark submissions. Other potential benefits suggested by consultation respondents included the reduced probability that firms will incur regulatory fines, and greater confidence in benchmarks in financial markets more generally.

**4.7** Respondents noted that quantifying the costs, and particularly the benefits, was challenging. Several respondents noted that the previous experience from introducing the regulatory regime for LIBOR, and implementation of the IOSCO principles, may offer guidance, although consideration needed to be taken of the heterogeneous nature of these markets. The importance of a full cost benefit analysis was noted.

## **Government response**

**4.8** The government is grateful to respondents for their views on the potential costs and benefits of bringing the recommended benchmarks within the regulatory perimeter, and for their support to the government's proposed approach for quantifying these impacts.

**4.9** The government agrees that undertaking a full assessment of these impacts is essential, and has produced a final-stage impact assessment. This quantifies the costs and benefits of passing domestic legislation that regulates these seven benchmarks, compared with waiting for EU benchmarks regulation to come into effect. The main affected groups are the contributing banks, the benchmark administrators and the FCA. The impact assessment quantifies the expected costs for these groups, building on the suggested areas raised in consultation about where these costs could fall.

**4.10** The main anticipated benefits include: improved resilience against attempted manipulation; reduced risk of misconduct and associated fines and/or litigation risk; decreased likelihood of cessation of these key benchmarks; increased credibility and integrity of these benchmarks among authorities, market participants and the public; greater confidence in financial markets and increased governance and regulatory oversight. These suggested benefits align with the points raised by respondents in consultation. Given the nature of these benefits, it has not been possible to quantify them in the impact assessment.



# A List of respondents

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Argus Media Ltd  
Barclays Bank PLC  
British Bankers' Association  
BP International Ltd  
Citadel Europe  
CME Group  
FIA Europe  
ICAEW  
ICAP  
ICE Benchmark Administration  
ICE Futures Europe  
ICIS  
London Bullion Market Association  
New Change FX  
Platts  
Price Waterhouse Coopers  
Shell International Trading and Shipping Company Ltd  
Silver Institute  
Thomson Reuters  
Vitol Group  
Wholesale Market Brokers Association  
WM/Reuters  
World Gold Council





### **HM Treasury contacts**

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[www.gov.uk](http://www.gov.uk)

If you require this information in an alternative  
format or have general enquiries about  
HM Treasury and its work, contact:

Correspondence Team  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

Tel: 020 7270 5000

Email: [public.enquiries@hmtreasury.gsi.gov.uk](mailto:public.enquiries@hmtreasury.gsi.gov.uk)