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**European Securities and Markets Authority  
European Banking Authority**

Paris, 15 February 2013

**AFG response to the ESMA & EBA consultation on  
“Principles for Benchmarks-Setting Processes in the EU”**

**General comments**

The Association Française de la Gestion financière (AFG)<sup>1</sup> is grateful to have the opportunity to answer to the ESMA and EBA’s consultation on the regulation of indices. AFG fully supports the authorities’ objective to remove the risk of manipulation of any indices, as its members are regular users of such data for the management of assets.

We strongly believe that principles on benchmark related issues should be handled at the international level in order to insure a correct implementation for the benefit of our members and of the clients they serve. We think that such a task should be coordinated first at IOSCO’s level in order to achieve a robust and effective framework and therefore did also answer to the current consultation they have done on “Financial Benchmarks”.

Indeed, as soon as June 2003 AFG participated within Eama (The European Asset Management Association that later merged with FEFSI to become Efama) to the publication of a “Code of Best Practice Recommendations For the Governance, Construction and Use of Equity Indices”.

AFG would like to stress that its members are in majority users and not providers of indices. Mostly used as a market reference for commercial purpose, benchmarks are not usually linked to a financial flow.

Benchmarks and universe of benchmarks are large and diverse, thus AFG understands that the usage of indices for reporting and marketing purposes is not the point of the current consultation and that it is rightly not the intent of EBA and ESMA to regulate the use of indices in the fund industry but only the use of benchmarks in financial transactions.

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<sup>1</sup> The Association Française de la Gestion financière (AFG) represents the France-based investment management industry, both for collective and discretionary individual portfolio managements. Our members include 425 management companies as of end January 2012. They are entrepreneurial or belong to French or foreign banking or insurance groups. AFG members manage 2,650 billion euros in the field of investment management as of end December 2011, making the Paris Fund Industry the leader in Europe for the financial management of collective investments. In the field of collective investment, our industry includes – beside UCITS – employee savings schemes and products such as regulated hedge funds/funds of hedge funds, private equity funds, real estate funds and socially responsible investment. AFG is of course an active member of the European Fund and Investment Management Association (EFAMA) and of PensionsEurope. AFG is also an active member of the International Investment Funds Association (IIFA).

This being said the fund industry, via specific funds, and among them ETFs, is a common user of benchmarks and in that context is expecting harmonization of a framework in the interest of its clients.

AFG members would welcome more transparency from indices providers. The expectation on transparency covers: construction of the index, underlying data, methodologies, contribution, composition and all information that can proof the adequacy of the benchmark to their need. We have two important suggestions concerning the benchmarks construction:

- The first one is on the calculation methodology. As regulation suggests that the benchmark reference to a performance should be with dividends reinvested, we would like those indices to be always provided when applicable by providers. Currently it is not always the case.
- The second one is linked to component selection. As many countries, France has signed the Oslo and Ottawa Conventions against controversial weapons. Therefore AFG made a clear recommendation to its members that portfolios should not include shares or bonds of producers of cluster bombs and landmines. Publication at no extra cost of “clean” indices is therefore a necessity.

AFG would like also to take the opportunity here to highlight to the authorities a negative point we face in our business concerning benchmarks: could they make sure that index providers do not create monopolies enabling them to overcharge unduly their clients or make them systematically pay for any reference to an index, even when it is not used for portfolio management?

AFG is indeed deeply concerned with the economic consequences of new regulation introduced by ESMA’s guidelines on ETFs and other UCITS matters with respect to free access by investors to information on the methodology and the components of benchmarks. As subscribers to the services of the benchmark producer, asset managers have access within short delay to most of the required information. On the other hand, the public at large can only get a restricted access (if any) free of charge. The case of fund’s investors that refer to benchmarks (like ETFs) has to be addressed as they should legitimately have a larger access than the public at large but cannot require the asset manager to be in breach of its license contract and communicate confidential information. A realistic compromise should be found or imposed by regulation on the level of necessary information accessible at a reasonable cost.

### ***Question 1: Definition of the activities of benchmark setting***

***Do you agree with the definitions provided in this section? Is this list of activities complete and accurate?***

**§11-i:** it is of prime importance that we reach a common definition of “benchmark” at an international level. More precisely, the 3 additions suggested by ESMA to the definition proposed by the Commission in its November consultation are not necessary.

- “Entirely or partially” : is a unnecessary precision at that level;
- “or an assessment of” : raises more questions at that level on what is a ‘value’;
- “or the value of a financial instrument” : all financial instruments might be concerned so this extension of the scope is too large.

**§11-x:** “Benchmark users” a further clarification should be added to make it explicit that market participants that use benchmarks for marketing and reporting purposes are not to be considered as “users” for the scope of this consultation and any future principles or regulatory framework.

## ***Question 2: Principles for benchmarks***

***Would you consider a set of principles a useful framework for guiding benchmark setting activities until a possible formal regulatory and supervisory framework has been established in the EU?***

AFG's opinion is that a benchmarking setting process is a global operation therefore there is no need to anticipate the on-going process conducted by the European Commission and IOSCO to issue guidance on defining global principles for the setting of benchmarks.

## ***Question 3: General principles for benchmarks***

***Do you agree with the principles cited in this section? Would you add or change any of the principles?***

### A.1 Methodology

AFG believes that there is a misunderstanding of the role of liquidity relative to benchmarks. In general, benchmarks increase the liquidity of a market. They don't need to be made of underlying that are themselves liquid. Instruments that refer to benchmarks, like futures for example, are in general more liquid than the underlying. There are even benchmarks whose underlyings are not liquid at all, like weather indices; they provide, however, some liquidity to markets.

We would rather replace this criterion by the fact that the benchmark should be transparent about the liquidity of the underlying.

AFG supports the need for representative, able to be replicated, measured and sufficiently liquid benchmarks. In the case of the liquidity precondition it should be considered on a relative basis as the adequacy of this precondition depends on the type of the underlying assets and the market targeted. It should be considered on a relative basis with reference to instruments sufficiently liquid within their asset class. Better, reference should be made to an adequate price formation process. For example, we cannot pretend that high yield bonds are sufficiently liquid in general terms.

### A.2 Governance Structure

Transparent governance is a pivotal principle. A binding code of conduct including measures such as independent audit and sanctions similar to the ones in the market abuse regime as well as consultation with the end-user of the relevant benchmark are amongst the main safeguards for achieving transparent governance structures.

### A.3 Supervision

With respect to the supervision, it is important not to jump to the conclusion that the relevant supervisory authorities should exist and be governmental bodies, as a Self-Regulatory Organization run by professionals might be appropriate.

#### A.4 Transparency

Transparency should be considered as an integral part of the benchmark-setting process. A code of best practices for benchmark providers would allow a more accurate selection of benchmarks and higher consistency regarding investment strategies.

Publication on a daily basis of benchmark prices along with their constituent and structure parts would be obviously more transparent but it not realistic. Both commercial and systemic reasons make that the data should be published with a modest time lag, especially in the cases where delaying publication of data can mitigate any impact. Regulators and market participants have to jointly decide on the sufficient level of transparency.

Particular attention should also be paid to the costs of transparency and in particular the costs for benchmark users to have access and get a license to use benchmarks.

In the case of asset managers they are called to pay data licenses to access many benchmarks. On top of that they are called to pay for an extra license to transfer information to their investors as this is required by the UCITS Key Investor Information Document (KIID) and the recently published ESMA guidelines on ETFs and other UCITS issues. It is unacceptable that asset managers are being called to pay double fees in order to comply with regulatory requirements which are being perceived as “business opportunities” by benchmark providers. This issue should be fully addressed by any future set of principles or regulation by taking a reasonable commercial cost approach as presented in the EU Commission consultation paper (non-discriminatory access to and obligation to license use of indices on a reasonable commercial basis).

ESMA should also take into account innovation in indices. Indices are an area where a lot of research is happening. There are plenty of new indices, sometimes named “smart beta” indices. Some providers of smart beta solutions invest of lot of efforts and research in producing these indices. If ESMA transparency requirements create an obligation to disclose all the calculations and parameters, there is a risk that innovation will be stifled in this area. That would not be in the best interests of investors. A whole range of investment solutions will disappear for investors. There should therefore be some limits to transparency.

#### A.5 Continuity

In principle the choice of new or alternative benchmarks should be left to users based on their analysis on which benchmarks better suit their needs. In the case of new indices and benchmarks any transition from old to new ones should be carefully calibrated and market participants be given sufficient time. Any ad hoc change in a very short time which can disturb legal clarity should be avoided. A well-defined transition period and regulatory safeguards that will protect legal validity of existing contracts are also important.

#### ***Question 4: Principles for firms involved in benchmark data submissions***

***Do you agree with the principles cited in this section? Would you add or change any of the principles?***

AFG agrees on the principles expressed by EBA and ESMA about benchmark data submission in general but with the exception of the last one (B.11) which should only apply if regulation is based on a professional code of principles which does not amount to hard legal framework. There is no need to ask anyone to comply with the law.

Furthermore, we consider it might be difficult and not efficient to perform internal controls as developed in B.8.

***Question 5: Principles for benchmark administrators***

***Do you agree with the principles cited in this section? Would you add or change any of the principles?***

AFG is in favor of the institution, explicitly discussed by IOSCO and only implied here in C.2, of an “oversight committee” within benchmark administrators.

Another overarching principle is not explicit in the present consultation: the fact that the administrator is responsible for the whole process of benchmark setting, even if it relies on outside parties for different functions.

The principles should address the issue of the license policy of the benchmark producers and the cost for users. The “reasonable price” approach could then be part of best practices or regulation.

If minutes of the meetings should be established and recorded (see C.8), it is not adequate to require them to be posted. These minutes should only be available to any supervisory authority, but public or subscribers should not have access to them, except in the framework of a judicial action.

Like for question 4 on B.11, last point (C.14) should only apply if regulation is based on a professional code of principles which does not amount to hard legal framework. There is no need to ask anyone to comply with the law.

***Question 6: Principles for benchmark calculation agents***

***Do you agree with the principles cited in this section? Would you add or change any of the principles?***

Relationships between benchmark administrators and calculation agents should, in AFG’s view, be contractually defined. Delegation is the appropriate framework that should be used with all the consequences it implies, notably in terms of liabilities. As a consequence D.6 is redundant with the due diligences conducted by the administrator.

***Question 7: Principles for benchmark publishers***

***Do you agree with the principles cited in this section? Would you add or change any of the principles?***

Delegation is an appropriate framework to fix relationships between administrators and publishers and define their respective roles.

***Question 8: Principles for users of benchmarks***

***Do you agree with the principles cited in this section? Would you add or change any of the principles?***

Asset managers as users carry validation exercises and monitor the data used to construct benchmarks as a part of their portfolio management. However they are not in the position to verify the construction or the accuracy of a benchmark and although they use some techniques to help identify the appropriateness of a benchmark for an investor, they cannot guarantee it.

It is not appropriate that they should conduct any due diligence on benchmarks that are underlyings of listed and actively traded futures or options on which they may trade in the ordinary course of its fund management activities. In this case, asset managers should rely on the procedures of the market infrastructure that listed those instruments.

***Question 9: Practical application of the principles***

***Are there any areas of benchmarks for which the above principles would be inadequate? If so, please provide details on the relevant benchmarks and the reasons of inadequacy.***

Globally, the principles as expressed in this consultation are not yet crafted with sufficient clarity to envision their application. Many questions of interest have been raised and discussed by IOSCO on which it is important to come to a common view at an international level before any regulatory decision.

***Question 10: Continuity of benchmarks***

***Which principles/criteria would you consider necessary to be established for the continuity of benchmarks in case of a change to the framework?***

This concern is a very good example of an important issue where IOSCO provides interesting thoughts to be discussed in the framework of its consultation paper (Chapter 4, section B. Transition issues).

AFG agrees that benchmarks might become less representative due to market evolution. It is as important to keep innovating new benchmarks as to make sure they are still representative. Stress resilience and market representation of the index or benchmark are essential characteristics and this last section of the consultation is not the least interesting.

Asset managers or their clients are in charge in our view for the selection of the benchmark. Therefore in case of any change on a benchmark for any reason, replacement should be determined by asset managers or their clients.

Change of index and transition to a substitute should be authorized, but not imposed by the regulator. It may be appropriate to include a clause in the documentation whereby counterparties agree to either close the contract or change reference if necessary or simply suitable to both.

If you need any further information, please don't hesitate to contact Eric Pagniez at +33.1.44.94.94.06 (e.pagniez@afg.asso.fr).

Sincerely Yours,

(SIGNED)

Pierre BOLLON