ICI VIEWPOINTS

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One Size Does Not Fit All in Regulation of Financial Benchmarks

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Following controversy surrounding calculation of the London Interbank Offered Rate (LIBOR), international regulators are closely scrutinizing the methodology, use, and oversight—among other issues—of financial benchmarks.

In recent letters to the European Commission, the International Organization of Securities Commissions (IOSCO), and the European Securities and Markets Authority (ESMA), ICI and ICI Global have urged regulators to distinguish between different categories of benchmarks. Not all benchmarks raise the same concerns as LIBOR. While regulators have identified a number of concerns with respect to LIBOR and other survey-based benchmarks, applying the same regulatory response across a broad range of benchmarks is unnecessary and inappropriate, and will lead to needless costs, which will be borne by investors.

Survey-Based Benchmarks

ICI and ICI Global have supported efforts to reform the process for establishing LIBOR and other survey-based benchmarks. In particular, we support measures that could strengthen the credibility of those benchmarks, improve governance over rate submissions and calculations, and make the rate-setting process more fact-based and transparent by using transaction data to the greatest extent possible.

Commercial Indices

In ICI and ICI Global's view, clear distinctions exist between survey-based benchmarks and commercial indices that are licensed for a fee, such as the S&P 500. These indices share characteristics that mitigate the concerns about survey-based benchmarks.

- *The data are more robust for commercial indices*. The underlying data for securities indices typically are taken from a regulated exchange or other source of market bids, offers, or executed prices. This is in stark contrast to survey-based benchmarks such as LIBOR, which require subjective estimates of the price of theoretical transactions.
- *Administrators of commercial indices have less discretion*. For a number of reasons, there is far less administrator discretion with respect to a commercial securities index, and what minor discretion the administrator has presents little opportunity for manipulation.
- *Administrators of commercial indices have every incentive to prevent manipulation*. Most importantly, index providers have a strong commercial incentive to provide high-quality indices for asset managers. Any commercial index provider that allowed—or that even was perceived to allow—manipulation of its benchmarks would stand to lose far more than it could gain from any potential manipulation.

Given these distinctions, we believe regulators should evaluate benchmarks and commercial indices separately. One size does not fit all.

The regulatory process works best when regulators first identify specific concerns that warrant intervention, and then develop rules that address those concerns. IOSCO and ESMA are taking that approach with respect to LIBOR and other survey-based benchmarks, and we commend them for it. But IOSCO and ESMA have not laid that same foundation regarding categories of benchmarks, like commercial indices, that have not shown the failures seen in survey-based ones. Before going any further, they should do so.

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