



The Consumer Voice in Europe

## **BEUC Response to the European Commission Consultation Document on the Regulation of Indices**

**'A possible framework for the regulation of the production and use of indices serving as benchmarks in financial and other contracts'**

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BEUC welcomes the opportunity to make a submission to this consultation.

Consumers do not produce and do not contribute to the development of benchmarks. However, many of the contracts they are engaged in contain indices used as benchmarks they have not chosen. While many of them are based on national data collected by national institutes of statistics and used for instance for housing rental, most benchmarks in the financial services area are produced by the private sector. They affect mortgage credits, consumer credits, overdraft facilities, credit cards, revolving credits.

The critical role LIBOR/EURIBOR and other benchmark rates play in financial markets and economic activities means that the governance structures and regulation relating to the setting and publishing of these rates needs to comply with the highest standards. However, recent events (Libor manipulation) show that the governance and regulation of these benchmark rates is flawed and needs to be fundamentally reformed.

It seems also that other key benchmark rates and mechanisms are vulnerable to similar conflicts of interest and weak governance flaws evident in the LIBOR situation. These include: the critical Price Reporting Agencies (PRAs) which compile commodity prices including oil, and a range of global interbank benchmarks including key European interbank benchmarks such as EURIBOR, BUBOR, CIBOR, PRIBOR, and WIBOR.

As an example, our Norwegian member Forbrukerradet (NCC) points out that since August 2011 the NIBOR (Norwegian Interbank Offered Rate) has been calculated and published by Finance Norway (FNO), a trade organisation for financial institutions established in 2010 to protect the interest of the financial institutions in Norway. FNO has drafted the guidelines for the interbank lending rates and appointed the members of the interbank lending rate panel, all members of FNO. The NIBOR is based on a simple average estimate of a selected number of member panel banks' rates, but not the rate accepted in practice. Any disputes are solved within the organisation with no transparency or public reporting to Finanstilsynet, the Financial Supervisory Authority, or any other supervisor.

In the area of energy, our UK member Which? has specific concerns about the way electricity is traded in the United Kingdom. Over the past decade most electricity in the UK has been traded over-the-counter (OTC) and accounted for around 97% of electricity trades in 2008/9. The prices being paid through OTC trades are gathered by price reporters, such as ICIS Heren. They do this by calling the OTC traders around the time the market closes to get a sense of the day's trades. The information gathered is then compiled and published daily as a market index. These prices have no formal role in the market but are used generally as reference. Although from conversations with traders, it is clear their opinion varies as to how reliable such reference prices are.

Market abuse in any form of manipulation of benchmarks in any market has a serious effect on the function of a benchmark as a steering rate within the individual market, and therefore is a threat to price stability, fair trade and confidence in the system. If there is no confidence in the steering function of benchmarks, markets are at risk and fair trade can be hindered. This could affect the overall trust between contractual parties and reduce the possibility for consumers to get right information to make the best choice. Simultaneously it gives an unfair advantage to those who play by the rules and those who do not.

## **BEUC Response to questions 12-13 & 28-29: Transparency and governance requirements; need for regulation, supervision and sanctions**

The current governance arrangements mean that banks which may stand to gain from manipulating rates have a major influence over the submission of constituent rates and the process of setting rates. There is no meaningful independent oversight.

We propose that **new governance arrangements** are put in place. Our key recommendation is that for the major European reference rates a new, independent Market Rates Oversight Committee should be established under the auspices of the European Supervisory Authorities (ESAs) or relevant national supervisors.

This committee should be responsible for oversight of the rate setting process including:

- the eligibility of participating financial institutions and instruments;
- the submissions process;
- the methodology used for rate setting; and
- the process for the publication of rates.

The composition of this committee should be properly balanced with a majority of seats given to independent, public interest representatives. Clearly, it would not be appropriate for any financial institution with a commercial interest in rate setting to be involved in the committee.

As part of such a governance reform, **the transparency** of the rate setting process needs to be improved. This can be achieved by an obligation to publish the names of the committee members and publish the minutes of its meetings. The minutes could be suitably drafted to protect genuine commercial confidentiality.

The submission process is flawed and open to abuse. Moreover, rates do not necessarily reflect true market conditions as the submissions are based on the judgment and inference of those making submissions, not actual transactions – this can leave the process open to manipulation. Setting rates based on actual transaction data offers significant advantages compared to offered rates which are more vulnerable to manipulation, and poor judgment.

Therefore, a standardised, transparent and independently monitored **process** is needed for overseeing and verifying the individual submissions by participating financial institutions.

The new committee outlined above should develop and publish a new submission process setting out clear rules for participating institutions with regards to:

- the responsibilities of employees involved in submitting constituent data;
- the process for submitting constituent data to the committee;
- the methodology for calculating the benchmarks; and
- verification and corroboration of constituent data.

There are two possible options for improving the existing system. One approach would be to use actual money market transactions data. This would deal with many of the concerns around governance and quality of submitters' judgment.

Alternatively, a hybrid system could be introduced. The current system which is vulnerable to manipulation could be enhanced through the use of market

transactions data to corroborate submissions.

**Regulation, oversight, and sanctions:** the existing legal and regulatory framework within Member States and at EU level is piecemeal and inconsistent. To create a more robust and consistent regime two actions are needed:

- the setting of benchmark rates should be made a regulated activity with sanctions in case of non-compliance; and
- EU policymakers should establish harmonised legislation to ensure that Member States implement proper regulatory and legislative powers.

The oversight of critical benchmark rates should come under the authority of the relevant European Supervisory Authority and national supervisory authorities where appropriate. Moreover participating financial institutions and employees should be subject to appropriate supervision and be covered by a relevant criminal sanctions regime. New criminal sanctions are necessary to provide a credible deterrent. National regulators should be given the power to prosecute individuals for attempting to manipulate benchmarks. Possible sanctions should include fines and allow for a ban on individual to work in the industry. This will ensure that senior management of banks has a strong reason for ensuring robust standards within their individual institutions.

**Redress mechanism:** BEUC and its members wrote a letter to the President of the European Commission in July highlighting the urgent need for an EU-wide collective redress mechanism. By manipulating benchmarks, banks were effectively stealing money from customers and counterparties. The benefit to banks from manipulating Libor and EURIBOR may be substantial, but the potential detriment to consumers is spread among a large number of people. As these manipulations resulted only in small individual losses and because of existing barriers to consumer access to justice (disproportionate costs, consumer inertia), these practices remain largely unchallenged on an individual basis. Nevertheless, such practices can still present a significant incentive to 'bend the rules' or lower standards because where they affect large numbers of consumers, the global benefit to the financial institution (and consequently, the total customer detriment) can be substantial. In these circumstances, there is no easy way for consumers to identify whether they have been affected and claim redress. Even if consumers were aware that they had been affected by such manipulations, they would not be able to complain to the bank responsible and would be unable to take their case to the Financial Ombudsman, where such an institution exists. This in itself weakens the incentives on the banks to behave appropriately. The lack of collective redress punishes those firms playing according to the rules as the firms, who did manipulate rates, get to keep their unlawful gains.

### **BEUC Response to questions 30-33: Appropriateness of benchmarks**

While in Europe the majority of variable rate mortgages are indexed to interbank rates, this is not the case in all countries. For example, in the early '90s Test-Achats, the Belgian consumer organisation, campaigned for a regulation<sup>1</sup> protecting consumers from benchmarks that could be manipulated or influenced by lenders for all mortgage credits taken out in Belgium. This is the reason why mortgage credits in Belgium are indexed on State bonds and not on EURIBOR.

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<sup>1</sup> [http://www.fsma.be/~media/Files/fsmafiles/wetgeving/kb\\_ar/rd\\_11-01-1993.ashx](http://www.fsma.be/~media/Files/fsmafiles/wetgeving/kb_ar/rd_11-01-1993.ashx) (FR&NL)

The Belgian law provides rules for loans taken out in another currency than Euro where the lender has to select a benchmark complying with the following criteria:

- a) its construction cannot depend on the lender;
- b) the borrower can follow its evolution without the intervention of the lender;
- c) it should be representative of changes in interest rates on capital markets and monetary currency referred.

This national example raises the question of appropriateness of some benchmarks for consumer contracts.

In the UK, short term tracker mortgages are tied to the Bank of England Base Rate which is much more transparent. In Slovenia, banks occasionally use benchmarks as the ECB key rates or maximum default rate (ECB rate + 8%). However, the decision on which rate to use is on the banks.

In the UK, it has also to be noticed that for customers on genuinely floating rates, banks are free to alter the rate at their own discretion; they do not need to link to a benchmark at all. This is in itself something which, our UK member, has been critical of recently as customers (particularly those who are trapped on their Banks Standard Variable Rate) are often faced with significant increases in rates in an environment where nothing else has really changed.

In Italy, a 2009 law requires banks offering mortgages for the purchase of a principal house to offer loans indexed to the ECB rate alongside (the standard) loans indexed to EURIBOR. But, often banks increase the spread, making loans indexed to the ECB rate more expensive than others. Therefore, no one chooses them beyond the fact that the bank staff does not mention them.

Germany has a long term case-law calling especially long-term savings and credit variable rates arbitrary, if they are not referring to an objective market interest rate. These rates have to be out of the influence of lenders/banks:

*Wenn sich eine Bank in einem formularmäßigen Kreditvertrag einseitig eine Zinsänderung vorbehält, so ist eine derartige Klausel grundsätzlich dahin auszulegen, daß sie lediglich eine Anpassung (Erhöhung oder Senkung) des Vertragszinses an kapitalmarktbedingte Änderungen der Refinanzierungskonditionen der Bank gem. § 315 BGB ermöglicht. Eine solche Klausel hält der Inhaltskontrolle nach § 9 AGB-Gesetz stand. (BGH, Urteil vom 06-03-1986 - III ZR 195/84 (München))*

The German Bundesgerichtshof ruled for the calculation of prepayment instruments that an artificial index on options to refinance prepaid loans was not to be considered adequate in that respect: *Banken dürfen ihre Vorfälligkeitsentschädigungen, die bei vorzeitiger Ablösung eines Immobilienkredits anfallen, nicht anhand der (Wiederanlage-)Renditen des PEX-Index berechnen. Denn, so der Bundesgerichtshof, der PEX-Index weise systemimmanente Schwächen auf, die dazu führten, dass an den Kreditnehmer Forderungen gestellt würden, die den tatsächlichen Nachteil von Hypothekenbanken aus der vorzeitigen Ablösung von Realkrediten überstiegen. Der BGH befürwortete eine Berechnung anhand der Renditen aus der Kapitalmarktstatistik der Deutschen Bundesbank. (Urteil vom 30.11.2004, Az.: XI ZR 285/03).*

**BEUC Response to questions 34-37: Some indices are public goods**

Some indices should be public goods including those used for all types of credit taken out by consumers. Such a decision would have two possible consequences: either regulating the indices provided by the private sector (see our proposal as described above), or going further by asking public bodies to produce indices or using existing rates like central bank rates.

The second option would need to be fully evaluated to establish the pros and cons: managing the transition to new benchmarks could be difficult given the potential for disruption and the need to renegotiate contracts.

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