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From: UK Parliament
date of receipt: 2 December 2013
To: President of the Council of the European Union

Subject: Proposal for a Regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts

Opinion¹ on the application of the Principles of Subsidiarity and Proportionality

Delegations will find attached the above mentioned Reasoned Opinion of the House of Commons.

Encl.: [...]

¹ Translation(s) of the opinion may be available on the Interparliamentary EU Information Exchange site IPEX at the following address: <http://www.ipex.eu/IPEXL-WEB/search.do>



HOUSE OF COMMONS

President of the Council of the European Union
Council of the European Union
Rue de la Loi 175
1048 Brussels
Belgium

By email: sj6.parlnat@consilium.europa.eu
dri.parlnat@consilium.europa.eu

2nd December 2013

Dear Mr President,

EUROPEAN UNION DOCUMENT NO. 13985/13 AND ADDENDA 1 AND 2,
A DRAFT REGULATION ON INDICES USED AS BENCHMARKS IN
FINANCIAL INSTRUMENTS AND FINANCIAL CONTRACTS

On 2 December 2013, the House of Commons of the United Kingdom Parliament resolved as follows:

That this House considers that the draft Regulation on indices used as benchmarks in financial instruments and financial contracts (European Union Documents No. 13985/13 and Addenda 1 and 2) does not comply with the principle of subsidiarity, for the reasons set out in the Annex to Chapter 5 of the Twenty-third Report of the European Scrutiny Committee (HC 83-xxi); and, in accordance with Article 6 of Protocol (No. 2) annexed to the EU Treaties on the application of the principle of subsidiarity and proportionality, instructs the Clerk of the House to forward this reasoned opinion to the Presidents of the European Institutions.

I enclose the relevant extract of the report.

Yours sincerely,
Robert Rogers

Sir Robert Rogers KCB, Clerk of the House of Commons
London SW1A 0AA T: 020 7219 1310/3758

Reasoned Opinion of the House of Commons

Submitted to the Presidents of the European Parliament, the Council and the Commission, pursuant to Article 6 of Protocol (No. 2) on the Application of the Principles of Subsidiarity and Proportionality.

concerning

a Draft Regulation on indices used as benchmarks in financial instruments and financial contracts¹

Treaty framework for appraising compliance with subsidiarity

1. In previous Reasoned Opinions, the House of Commons has set out what it considers to be the correct context in which national parliaments should assess a proposal's compliance with subsidiarity. The House of Commons continues to rely on that context without restating it.

Proposed legislation

Purpose

2. The overall purpose of the Regulation is to create a regulatory framework for indices used as benchmarks in financial instruments, financial contracts or to measure the performance of investment funds. The Commission explains that “an index is a measure, typically of a price or quantity, determined from time to time from a representative set of underlying data. When an index is used as a reference price for a financial instrument or contract, it becomes a benchmark”.² The Commission says that “the integrity of financial benchmarks is critical to the pricing of many financial instruments”, including loans and mortgages and they “also play an important role in risk management”.³

3. The main objectives of the proposed Regulation, as summarised by the Commission in its explanatory memorandum, are to:

- improve the governance and controls over the benchmark process and in particular ensure that administrators avoid conflicts of interest, or at least manage them adequately;
- improve the quality of the input data and methodologies used by benchmark administrators and in particular ensure that sufficient and accurate data is used in the determination of benchmarks;

¹COM (13) 641, final, 18.09.2013.

² Page 2 of the Commission's explanatory memorandum.

³ *ibid.*

- ensure that contributors to benchmarks are subject to adequate controls, in particular to avoid conflicts of interest and that their contributions to benchmarks are subject to adequate controls. Where necessary the relevant competent authority should have the power to mandate contributors to continue to contribute to benchmarks; and
- ensure adequate protection for consumers and investors using benchmarks by enhancing transparency, ensuring adequate rights of redress and ensuring suitability is assessed where necessary.⁴

Operation

4. The draft Regulation is based on Article 114 TFEU which, with reference to Article 26 TFEU, creates a competence for the EU to adopt measures “for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market”.

5. In summary, the draft Regulation proposes to achieve the stated objectives by:

- imposing various governance requirements on administrators and contributors, such as managing conflicts of interest and transparency, as well as provisions relating to the input data and methodology of the benchmark itself. They also contain provisions relating to mandatory participation for contributors and third country equivalence for non-EU countries (Articles 2–21); and
- providing a procedure for authorisation and supervision of administrators by competent authorities and creating a mechanism for enforcement of the Regulation, for example by requiring Member States to provide competent authorities with certain powers (Article 22–41).

Subsidiarity

6. In its explanatory memorandum, the Commission asserts the proposal’s compliance with subsidiarity as follows:

“While many benchmarks are national, the benchmark industry as a whole is international in both production and use. While action at national level in relation to national indices may help ensure that any intervention is appropriately tailored to the problems at national level, this may lead to a patchwork of divergent rules, could create an un-level playing field with the single market and result in an inconsistent and un-coordinated approach. Benchmarks are used to price a wide variety of cross border transactions, in particular in the interbank funding market and derivatives. A patchwork of national rules would impede the opportunity to produce cross border benchmarks and therefore impede these cross border transactions. This problem has been recognised by the G20 and FSB which charged IOSCO with producing a global set of principles to apply to financial benchmarks. An EU initiative will help enhance

⁴ Page 2 of the Commission’s explanatory memorandum.

the single market by creating a common framework for reliable and correctly used benchmarks across different Member States.”⁵

7. The Commission also considers that EU level action is necessary to protect consumers:

- who do not possess the necessary knowledge or experience to appropriately assess benchmark suitability and who may be given a limited choice of benchmarks through standard contract terms and the force of unequal bargaining power — this will be addressed by the requirement that responsibility for checking the suitability of benchmarks for retail contracts rests with lenders or creditors; and
- who are based in different Member States from a fragmentary national approach to cross border financial contracts by enabling the use of cross border benchmarks.⁶

Aspects of the Regulation which do not comply with the principle of subsidiarity

i) Failure to comply with essential procedural requirements

8. By virtue of Article 5 of Protocol (No. 2) “any draft legislative act should contain a detailed statement making it possible to appraise compliance with the principles of subsidiarity and proportionality”. The requirement for the detailed statement to be within the draft legislative act implies that it should be contained in the Commission’s explanatory memorandum, which forms part of the draft legislative act and which, importantly, is translated into all official languages of the EU. The fact that it is translated into all official languages of the EU allows the detailed statement to be appraised for compliance with subsidiarity (and proportionality) in all the national parliaments of Member States of the EU, in conformity with Article 5 of Protocol (No. 2). This is to be contrasted with the Commission’s impact assessment, which is not contained within a draft legislative act, and which is not translated into all the official languages of the EU.

9. The presumption in the Treaty on European Union⁷ is that decisions should be taken as closely as possible to the EU citizen. A departure from this presumption should not be taken for granted but justified with sufficient detail and clarity that EU citizens and their elected representatives can understand the qualitative and quantitative reasons leading to a conclusion that “a Union objective can be better achieved at union level”, as required by Article 5 of Protocol (No. 2). The onus rests on the EU institution which proposes the legislation to satisfy these requirements.

10. For the reasons given below, we do not consider that the Commission has provided sufficient qualitative and quantitative substantiation in the explanatory memorandum of the necessity for action at EU level and the greater benefits it would achieve. This omission, the

⁵ Page 5 of the Commission’s explanatory memorandum.

⁶ Page 6 of the explanatory memorandum.

⁷Article 5 TEU.

House of Commons submits, is a failure on behalf of the Commission to comply with essential procedural requirements in Article 5 of Protocol (No. 2).

ii) Failure to comply with the principle of subsidiarity

11. The House of Commons considers that the impact assessment provided by the Commission provides insufficient detail of the necessity for such a broad proposal. It should also have provided a more considered estimate of the number of financial benchmarks likely to be covered. Instead, the impact assessment states that “the size of the market for financial instruments and contracts potentially impacted by the benchmark industry is enormous”, whilst also stating that “the approximate number of benchmark administrators under scope in Europe is 500 and the approximate number of contributors to benchmarks under scope is also 500”.⁸ Given the scope of this Regulation is intended to cover all financial benchmarks within the EU, these figures appear exceptionally low.

12. The House considers that the first limb of the test (“if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States”⁹) is not satisfied because:

- action at national level would allow each relevant Member State to address the particular problems associated with specific benchmarks and the benchmark-setting process in its jurisdiction;
- for the vast majority of benchmarks, actions by Member States alone would not conflict with or hamper the objectives of the proposed action and would be better taken at Member State level given that this action can be targeted to the particular issues concerning those benchmarks.
- national-level benchmark reform can be sufficiently effective as demonstrated by the action taken by the UK to:
 - ▶ reform LIBOR after the Wheatley Review — the Financial Services Act 2012 brought benchmark activities within the scope of regulation under the Financial Services and Markets Act 2000 and created a new criminal offence of making a false or misleading statement or impression in connection with the determination of benchmarks; and
 - ▶ make an active contribution to the work of the International Organization of Securities Commissions (IOSCO) in developing its *Principles for financial benchmarks*.

13. The second limb of the subsidiarity test (“but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level”¹⁰) requires sufficient evidence of the greater benefits of EU action. According to the Commission (see paragraphs 6 and 7 above)

⁸ Annex X to the Commission’s impact assessment: “Cost Benefit Analysis And Administrative Burden Calculation”

⁹ Article 5(3) TEU.

¹⁰ Article 5(3) TEU.

these benefits are the enhancement of the single market by creating a common framework for reliable and correctly used benchmarks across different Member States, the promotion of cross border transactions and the protection of consumers.

14. The House of Commons is not convinced by the Commission's assertion of these benefits because there is strong evidence from the UK financial services sector to demonstrate that they are outweighed by the potential disadvantages of EU-level action. This is because the proposal:

- seeks to regulate in a detailed manner the production and use of benchmarks which is so varied in nature that a harmonised solution, of such broad application, would be harmful, particularly as the rules proposed do not seem to be fully in line with internationally agreed IOSCO principles;
- would impose new burdens on administrators, contributors, regulators and others, with very limited regard for the nature of the relevant benchmark. These burdens may be very significant given that it is currently unclear how many benchmarks would be captured by this proposal — given the broad scope of the proposal, which captures any index referenced in a financial contract, UK market participants estimate the number of benchmarks captured could be, at least, in the tens of thousands;
- may, through the imposition of such burdens, result in the discontinuance of some existing benchmarks and impede the creation of new benchmarks;
- could compromise the independence of national statistics authorities as producers of official statistics relating to the economy, population and society at national, regional and local levels — their special features, and the role they play, mean it is not appropriate for them to be required to be authorised and supervised, in the manner proposed by the Commission with the envisaged role for the European Securities Markets Authority (ESMA); and
- would not address the need to properly allow for benchmarks used in non-EU jurisdictions to be used within the EU and this could restrict the market in international financial transactions— benchmark reform is an international issue.

Conclusion

15. For these reasons the House of Commons considers this proposal does not comply with the principle of subsidiarity.