

Response to the European Commission Consultation on the Regulation of Indices

Reply of the European Federation of Financial Services Users (EuroFinuse)

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EuroFinuse the European Federation of Financial Services Users counts more than fifty national and international member and sub-member organizations comprising about four million individual members. EuroFinuse acts as an independent financial expertise center to the direct benefit of the European financial services users (shareholders, other investors, savers, pension fund participants, life insurance policy holders, borrowers, etc.) and other stakeholders of the European financial services who are independent from the financial industry.

EuroFinuse has experts participating in the Securities & Markets, the Banking and the Pensions Stakeholder Groups of the European Supervisory Authorities, and the EC Financial Services User Group. Its national members also participate in the national financial regulators and supervisors bodies when allowed. For further details please see our website: www.eurofinuse.org.

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Executive Summary

EuroFinuse welcomes the consultation from the EC on the regulation of indices. Individual financial services users are indeed using indices a lot either willingly or unwillingly:

As investors and savers - many retail investment products have their performance linked or benchmarked to indices;

As borrowers - almost all variable rate loans have their interest rate linked to indices: LIBOR or EURIBOR in particular.

While many of the questions raised by the EC are targeted at index providers and professional users, some are directly relevant to individual financial services users.

Based on evidence, EuroFinuse demands that:

- **Indices** used as key benchmarks for widely used retail products, and intended to measure the price or performance of an opaque and/or illiquid market (such as the interbank short term loans market for example and the index supposedly measuring it, the LIBOR) **are thoroughly regulated;**
- **The information of** other widely used financial indices such as many **equity or bond indices should be made available** by index providers to the general public;
- Public supervisors should thoroughly **enforce** the requirement **for index performance information to be exact, fair and not misleading**, as evidence of the contrary is widespread.
- The EC should **launch an investigation on the currencies markets public price and index information** made **available to the general public**. The currencies market is by far the biggest financial market in the world but also the least regulated, and therefore remains quite non transparent for EU citizens. Regulators and supervisors should learn the lesson from the unregulated and misleading LIBOR “market”.

EuroFinuse considers the widespread cases of index manipulation very worrying and would like to reply specifically to the following questions:

Chapter 1. Indices and Benchmarks: What they are, who produces them and for which purposes

N/A

Chapter 2. Calculation of Benchmarks: Governance and Transparency

(23) Do you consider that responsibility for making adjustments if inadequate data is available should rest with the contributor of the data, the index provider or the user of the index?

The index provider has to be responsible for the quality of the chosen data.

(24) What is the formal process that you use to audit the submissions and calculations?

N/A to individual investors and other retail financial services users

Chapter 3: The Purpose and Use of Benchmarks

(30) Is it possible and desirable to restrict the use of benchmarks? If so, how, and what are the associated costs and benefits? Please provide estimates.

The use of benchmarks that are mostly relative and/or subjective should at least be restricted with a warning label.

Quite a few active retail investment funds benchmark their performance to “peer group” average performance. This has very little value compared to benchmarks on the performance of underlying asset classes and can be very misleading as evidence shows that

over the mid to long-term investment funds tend to underperform the underlying asset classes or segments¹. For example, if a bond fund over performs his “peer group” it does not mean that it is performing per se, as over the last 10 years only 20 % of investment funds sold in Europe over performed the relevant bond indices.

Also, we have quite a lot of evidence of investment fund providers communicating false benchmark data to retail investors, in particular with regards to the new KIID.

Eurofinuse tested four index funds KIIDs: all of them provided false or at least inconsistent index performance data! They concerned widely used equity indices: MSCI and NYSE Euronext. In addition, for one of them the data were grossly incorrect and misleading for all years mentioned. EuroFinuse filed a complaint for the latter index fund KIID with the competent Member State supervisor and is willing to provide all detailed evidence to the EC on request. Obviously the requirement of exact, fair and not misleading information on indices is not properly enforced. Therefore the European Supervisory Authorities should put an end to these illegal but widespread behaviours.

Besides, the accuracy and truthfulness of those indices are almost impossible for an individual to verify, because the information was not made publicly available by the index providers: the past performance (yearly, quarterly and monthly) should be made accessible to retail investors and borrowers without any restrictions and free of cost. In addition, the KIID or equivalent product information should provide a proper and precise link to this information.

(31) Should specific benchmarks be used for particular activities? By whom? Please provide examples.

The use of benchmarks should not be misleading (in the sense of MiFID terminology). For example, the EU should eventually prohibit the use of equity “price” indices as performance benchmarks for investment funds that reinvest dividends: they should use “total return” indices. This is very confusing for individual investors in particular. We can provide the EC with specific evidence if needed.

¹ According to Lipper research, “Beating the Benchmark”, March 2012, page 6, Figure 3. For 10-year periods (considered timeframe December 1991 to December 2011), for only one of the cases funds ‘rolling returns outperform benchmarks in over 50% of the times. Indeed, some of the funds (Euro bond funds, USD bond fund) almost always underperform their benchmarks; and the rest of the funds outperform their benchmarks in a very limited percentage

<http://funds.uk.reuters.com/UK/pdf.asp?language=UNK&dockey=1523-4357-1MUR4NKAQL1P7BS2U69G44FT7O>

(33) Who should have the responsibility for ensuring that indices used as benchmarks are fit for purpose, the provider, the user (firms issuing contracts referenced to benchmarks), the trading venues or regulators?

The requirement for fair, precise and truthful information given by the choice of the benchmark is a responsibility of the regulator as per the MiFID Directive.

Chapter 4: Provision of Benchmarks by Private or Public Bodies

(34) Do you consider some or all indices to be public goods? Please state your reasons.

We believe when markets are not transparent and/or illiquid, they are not functioning well. When those markets form the basis for key indices for the real economy and for EU citizens they should then be considered public goods and be regulated.

A typical example is LIBOR: the interbank short term bank loans were totally unregulated. Following the LIBOR scandal we discover that:

- this index is not based on actual transactions; and
- it would not be possible to base the index on actual transactions because there would be too few transactions;

However, firstly this remains to be proven, and secondly if proven, it means it is both a diffused and an illiquid “market” which should be regulated.

Also, as mentioned above, the key information of any index that is widely used for retail investment or a loan product should be made easily and freely accessible to the public. This would allow EU citizens to check the accuracy and truthfulness of index information given by the financial service provider. As already mentioned, in all four KIIDs of index funds tested, the past performance of widely used indices were at least partially false. It should be noted that it has been very difficult for EuroFinuse to find this out, as past performances of those widely used indices are not publicly available on the index providers’ websites.

Providers of widely used indices should be required to publish for free the past performance (yearly, quarterly and monthly at least) of their indices and the components of these indices

at the end of the last year, quarter and month.

(35) Which role do you think public institutions should play in governance and provision of benchmarks?

As mentioned above, some general principle regulations must apply to all widely used indices, and certain key indices coming from opaque and/or illiquid markets should be further regulated by public institutions.

(36) What do you consider to be the advantages and disadvantages of the provision of indices by public bodies?

Regulation is one thing. EuroFinuse does not see the added benefit for the users and taxpayers to have public bodies become index providers, except when they are profoundly used by the Governments themselves (for example a country consumer price index), or when there is a market failure to provide such indices in a compliant way.

(37) Which indices, if any, would be best provided by public bodies?

Chapter 5: Impact of Potential Regulation: Transition, Continuity and International Issues

N/A