Public Comment on Financial Benchmarks

Provided by The Baltic Exchange Ltd in response to the IOSCO Consultation Report on Financial Benchmarks.

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1. Do you agree with the scope of the report and intended audience? Are there other Benchmarks or stakeholders that have idiosyncrasies that should place them outside of the scope of the report? Please describe each Benchmark or stakeholder and the idiosyncrasies that you identify and the reasons why in your view the Benchmark or stakeholder should be placed outside of the scope of the report.

The scope of the report and the intended audience are appropriate. While is it not suggested that Shipping Market benchmarks such as those produced by the Baltic Exchange should be excluded from the review, it is important that the different characteristics of each market should be fully understood, especially if any eventual regulatory regime is highly prescriptive.

2. Do you agree that the design of a Benchmark should clearly reflect the key characteristics of the underlying interest it seeks to measure?

Yes. Baltic Exchange market benchmarks are specifically designed to reflect the lack of (what might generally be considered) liquidity and the highly non-standardised nature of the international bulk shipping markets.

3. What measures should Administrators take to ensure the integrity of information used in Benchmark-setting and that the data is bona fide? Please highlight any additional measures required where Benchmarks are survey based. Please also comment on each of the factors identified in the discussion on the vulnerability of data inputs such as voluntary submission, and discretion exercised by Administrators. Are these measures adequately reflected in the discussion of roles and responsibilities of the Administrator discussed in section E?

4. What measures should Submitters implement to ensure the integrity of information provided to Administrators? Are these measures adequately reflected in the discussion of a code of conduct for Submitters discussed in section E? In particular, should Submitters submit all input data, and not a selection of such data so as to maximise the representation of the underlying market? Please comment on any practical issues that compliance with such an approach may give rise to.

[Both questions answered together]

Baltic benchmarks rely on voluntary submission. However, this must be distinguished from sporadic submission. If a market participant were able to provide information on an ad hoc basis then this would potentially lend itself to abuse. In the case of Baltic benchmarks once a (competitive, commission-earning) broker has been appointed to the panel of Submitters for a particular route then he must contribute a rate every day.

However, the submission of rates does represent a significant burden on brokers and there is a concern that the imposition of overly onerous demands and (especially) penalties by regulators might act as a serious disincentive to submit rates.
It is difficult to see how it can be made compulsory for otherwise unregulated entities such as shipbrokers to submit rates and how the Benchmark Administrator would exercise any putative right to impose such a requirement.

The Baltic agrees that Administrators should provide procedures and policies governing submission discipline and currently does so via its publication entitled the Manual for Panellists.

The Baltic does not consider it appropriate for the Administrator to exercise discretion over the selection of inputs. Once a panel is appointed all inputs should be routinely used. If not then the Administrator is at risk of "managing" the outcome of the process.

We do not offer a view on other markets but are keen to emphasise that Baltic panel members are always competitive shipbrokers who do not have any investment in the market. They are required to comply with the Baltic Code of Conduct (being members of the Baltic Exchange) and to be cognisant of the demand of the Manual for Panellists. Since they do not have a direct financial interest in the market conflict of interest is minimised.

While submissions are never selected by the Baltic, there is a review process where submissions are considered by an internal team and possible or obvious error can be highlighted. In this event panellists are contacted and a discussion held with them as to the appropriateness of the rate they have provided. The Baltic never insists that a rate is changed.

This process is important since the rates are of necessity based only on market expert estimates. We therefore at times need to be able to confirm the panellist (submitter) has considered all appropriate factors and correctly interpreted the route definition contained in the Manual for Panellists.

Although the names of panellists are public (by category of ship rather than individual route), the Baltic keeps all submitted rates confidential. We consider this appropriate to protect panellists from any attempt at influencing them.

From long experience the Baltic some time ago abandoned the practice of removing the high and low submissions from the rates provided and moved to production based on an average of all data points. This is especially appropriate where expert views on relatively illiquid markets are concerned as it is important not to exclude information which potentially reflects current movements in the market which not all participants are yet aware of. Averages will always tend to lag the latest market developments and this would be exacerbated by removed of "leading" rates. We also noted that in the past, knowing that outliers would be removed, Submitters tended to second guess the mean and come closer to it in order to ensure their rate was not excluded.

It is reasonable for processes and computer systems programming and management to be outsourced, but this should always be distinct from handing off any actual responsibility for the method and the management of the index production.

5. What level of granularity with regard to the transparency of Methodologies would enable users to assess the credibility, representativeness, relevance and suitability of a Benchmark on an on-going basis and its limitations with respect to their intended use? Relevant factors could include; criteria and procedures used to develop the Methodology, type of data used, how data is collected, relative weighting of data used, how and when judgement is used, contingency measures (e.g., methods when transaction data is unavailable, etc.), publication of information supporting each Benchmark determination, etc. Please provide examples where you consider there are currently significant gaps in the provision of this information.
It should be possible for a data user easily to discover all information necessary to fully understand the benchmark definition and compilation process. In the case of the Baltic Exchange this means that the vessel description and the route definitions are all available via the www, along with the Manual for Panellists which defines the rules on submission for panellists and the calculation details including components of indices and averages and where required, adjustment ratios.

Individual submissions should not be made public in order to reduce the risk of attempts to influence submissions. The Baltic also does not disclose exactly which routes its panellists cover, for the same reason.

6. What steps should an Administrator take to disclose to Market Participants and other stakeholders the contingency measures it intends to use in conditions of market disruption, illiquidity or other stresses?

In the event that an Administrator wishes to exercise such a power it is critical to set it out in advance. However, the Baltic takes the view that the correct approach for its market is to publish the collected view of its expert panel and not to interfere with that process. On occasions where the market is disrupted or unusual this can lead to a wide range of views reflecting the different ideas of each panellist. However, by maintaining the method we consider we provide the best possible guidance to the market. This is distinct from a situation where it is simply impossible to report the market, where we would not do so.

7. What steps should an Administrator take to notify Market Participants of material changes to a Benchmark Methodology (including to Benchmark components) and to take their feedback into account?

The Baltic Exchange runs a User Group among its members and this is the vehicle for discussion in advance of all potential changes to the method or other details. Once a decision is taken this is also the main (though not the only) route for distribution of information. The goal is always to generate a consensus for necessary action between the users and the Submitters, but the Baltic retains the decision-making authority.

A key distinction is that between those users of data with whom the Administrator has a commercial or other contractual relationship and those who may make use of the data without a specific licence. The latter group may well not be made aware of changes, but are of course not contributing to the costs of the production and management process. The Baltic draws a clear distinction between these groups.

8. How often should the Administrator review the design and definition of the Benchmark to ensure that it remains representative?

This should be a continuous process with a willingness to act as needed. There is always a conflict between the desire to change in order (for example) to remain in line with the real physical marketplace and the perceived threat to liquidity, particularly in derivatives markets, which can be caused by a change to the benchmark. It is a fine judgement as to when change is essential and then a complex matter to resolve implementation issues and transition processes with clearing houses and all interested parties.

9. The Consultation Report discusses a number of potential conflicts of interest that may arise at the level of the Submitters, between Submitters at different entities, and between Submitters, Administrators and other third parties. Are there other types of conflicts of interest that have not been mentioned that you consider may arise? If so, how best should these conflicts of interest be addressed? Are the measures discussed in the Consultation Report sufficient to address potential conflicts of interests at the level of
the Submitters, between Submitters at different entities, and between Submitters, Administrators and other third parties?

It will not be possible in all markets, but using independent commission-earning brokers as Submitters minimises conflicts of interest among Submitters.

10. Do you agree that the Administrator’s oversight committee or other body could provide independent scrutiny of all relevant activities and management of conflicts of interest? Please comment if and why any different approaches might be appropriate for different kinds of Benchmarks. For example, where Administrators simultaneously act as the trade body for Submitters to the Benchmark. What is the minimum level of independent representation this committee or body should include?

The Baltic Exchange is both an industry association and a commercial entity. Its activities overall are supervised by its non-executive Board of Directors. The Board delegates to a Board Committee (the Freight Indices and Futures Committee - FIFC) the task of supervising and monitoring the indices. Co-opted onto this Committee are a number of industry representatives, including the chairpersons of the users' group and of the derivatives brokers’ association.

11. Should the Submitters establish accountability procedures to assess their compliance with operational standards and scrutiny of Benchmark submissions?

This should be carried out routinely by the Administrator. It is important to ensure that the present review does not increase the cost of compliance for Submitters to the point where they no longer have an interest in providing their input. In the Shipping market they are typically unregulated persons and they may be drawn from all locations around the world. There is no reason to impose a compliance burden on them if the Administrator takes responsibility for all quality control processes.

12. Are the measures discussed in the Consultation Report (e.g., Audit Trail, external audits and requirement for regulatory cooperation) sufficient to ensure the accountability of the Submitters? Should additional mechanisms be considered?

While the Baltic makes use of a number of "audit" processes, it is important to avoid incorrect assumptions about what can be achieved. We "audit" the panellist inputs on a daily basis (arguably review would be the accurate term). We also "audit" panellists each year to check their qualifications, though this is an informal process despite the name.

Independent auditors (Moore Stephens) audit the computer processes on a regular basis to confirm accuracy. They also review our audit visits to panellists.

In the case of the shipping market it would not realistically be practical to conduct a post facto audit of index results to check for accuracy as so little of this worldwide, private market is transparently known, even after the event

13. How frequently should Submitters be subject to audits? Should these be internal or external audits?

See above. Annual review of performance, combined with formal re-appointment is correct unless specific concerns arise.

14. Are the measures discussed in the Consultation Report (e.g., complaints process, Audit Trail, external audits and requirement for regulatory cooperation) sufficient to ensure the accountability of the Administrator? Should additional mechanisms be considered?

The proposals are sufficient.
15. If recommended, how frequently should Administrators be subject to audits? Should these be internal or external audits?

See above. Audit of systems and the application of processes is valuable. The judgement on whether they are internal or external should be left to the Administrator. It would be important not to impose very substantial costs on benchmark providers which might be disproportionate to the revenues they are able to derive from the process.

16. Is public self-certification of compliance with industry standards or an industry code another useful measure to support accountability? This approach might also contemplate explanation of why compliance may not have occurred. If so, what self-certification requirements would make this approach most reliable and useful to support market integrity?

The best approach would be to publish documentation setting out best practice and encourage Administrators to confirm their compliance or explain why they cannot or choose not to, comply on an annual basis (similar to the approach taken by the stock exchange regarding corporate governance). We would largely support the proposed Control Framework.

17. The Consultation Report discusses elements of a code of conduct for Submitters. Are the measures discussed (e.g., adequate policies to verify submissions, record management policies that allow the Submitter to evidence how a particular submission was given, etc.) sufficient to address potential conflicts of interest identified or do you believe that other control framework principles should be added?

Submitters in the Shipping Market do so in support of the industry and in particular their clients. They do not receive any financial reward in the process. Thus the burden of supervision and examination must fall largely on the Administrator, not on the Submitter. If a substantial burden of regulation falls on the Submitter, then there is a risk they will no longer be prepared to participate. They may already be subject to litigation in tort if they are negligent and otherwise if they are fraudulent. It is for the Administrator for monitor whether they have the right business to be submitters and are sufficiently diligent.

18. What would be the key differences in the code of conduct for Benchmarks based on different input types, for example transactions, committed quotes and/or expert judgement?

In the case of the Baltic Exchange benchmarks all inputs are based on judgements of the market. The Manual for Panellists (code of conduct) therefore sets out the matters which should and should not be taken into consideration in making a submission. For example, the panellist should not consider the motivation for an owner or charterer concluding a particular fixture at a particular rate, may consider different fixtures adjusted to the standard terms, and may consider the likely effect on the market of a particular known fixture (eg no ship left in position, no cargo remaining etc).

19. What are the advantages and disadvantages of making Benchmark submissions a regulated activity?

The main danger here is the imposition of a regulatory burden which is simply unacceptable to the submitter who then decides not to participate. It is difficult in most markets to force submission, even through regulation.

There is a danger in the proposals that a very elaborate structure is introduced which is not needed for the vast majority of benchmarks. A better solution for most benchmarks would be
guidance and compliance statements (see 16 above). This could be combined with a formal regulatory regime for the most risky benchmarks (eg where problems have already been observed; where there is a significant retail investor exposure etc).

20. What are the advantages and disadvantages of making Benchmark Administration a regulated activity?

The problem with a formal regulatory process is to determine the benefits which will accrue and where to draw lines. Before regulating it would be important to confirm that the problems observed were caused by a lack of regulation or will be solved by the regulation which is being introduced.

The production of benchmarks is generally a business which has low barriers to entry and therefore a highly competitive flavour. If such production becomes a regulated activity this may have the effect of entrenching the incumbent in position by increasing the barriers to entry for competition. Although benchmarks often establish a near monopoly position because of the consensus around them, they are subject to the discipline of competition. This should not be lost.

As stated above and in the paper, the issue is one of degree. There are many thousands of benchmarks, which although they may be used in derivatives markets, do not represent a problem area or a significant risk. If a universal regime of regulation is to be introduced the question (in addition to the obvious one of cost), will be who will regulate. It is likely that there is an assumption that the existing securities regulator in the Administrator's home jurisdiction will be the regulator. However, this will be at a time where there are major changes to regulation in all areas and will be an area where the regulator may have no expertise at all.

Regulation may protect providers of poor benchmarks or those which have failed to develop with the market by increasing barriers to entry.

21. Do you agree with the factors identified for drawing regulatory distinctions? What other factors should be considered in determining the appropriate degree of oversight of Benchmark activities (discussed in Chapter 3)? Please provide specific recommendations as to how the distinctions discussed in Chapter 3 should inform oversight mechanisms.

Yes, with additions. A regulated entity may not be an exchange but another regulated marketplace such as a Multilateral Trading Facility (MTF). There could be a distinction drawn between benchmarks which are based on actual physical market transactions and those based on judgements. Equally there is a clear distinction between those based on (anonymous?) surveys of the market and those based on formal submissions from identifiable counterparties (even if this information is not public). Finally and vitally there is a distinction between those submitters who are unavoidably conflicted (such as traders) and those (such as bona fide IDBs and shipbrokers) who are not inherently conflicted.

22. What distinctions, if any, should be made with regard to Benchmarks created by third parties and those created by regulated exchanges?

There is no particular reason to distinguish in of principle. If a regulated exchange (such as a stock market) is generating an index (eg a market index) using a properly documented process and transparent, publicly available data, there this is clearly lower risk than other circumstances. However, elements such as closing prices for individual stocks (which are also important benchmarks) are known to have been manipulated on occasions, so they are not immune.
The regulated entity (or more likely another firm in the group) may equally be producing a benchmark from other (e.g., physical) market data and be exposed to just the same issues as any other Administrator.

In other words, the fact of running a regulated market is not important in benchmark production. There may also be different corporate entities involved. The Baltic Exchange indices are produced and commercialized by Baltic Exchange Information Services Ltd, while the regulated MTF for freight derivatives is run by Baltic Exchange Derivatives Trading Ltd.

23. Assuming that some form of enhanced regulatory oversight will be applied to an asset class Benchmark, should such enhanced oversight be applied to the Submitters of data as well as the Administrator?

If there is to be one, the regulatory focus should be on Administrators, which would bring a manageable number of new entities into the regulated environment. If the approach is to regulate Submitters then the risk is of bringing possibly thousands of entities into the regulated world at vast and disproportionate cost.

24. What are the considerations that should be taken into account if the Submitters to a Benchmark operate in an otherwise unregulated market (e.g., physical oil, gold or agricultural commodity markets) and are not otherwise under any obligation to submit data to an Administrator?

If what they perceive to be an unreasonable burden of cost or regulation or risk of any kind is placed upon them, such Submitters can be expected to withdraw from the process.

25. Do you believe that a code of conduct, either on its own or in conjunction with other measures outlined within the report, would provide sufficient oversight to mitigate the risks that have been identified in Chapter 2? What measures should be established in conjunction with a code of conduct? For which Benchmarks is this approach suitable?

A code of conduct which is the responsibility of the Administrator is reasonable. It would be the responsibility of the Administrator to comply (or explain) and to monitor the compliance of Submitters, removing them from the role if they were inadequate. Any enforcement powers and penalties should generally be available only for extreme cases (fraud, continuing gross negligence, deception and market abuse). Note that Market Abuse is being covered elsewhere (the Market Abuse Directive).

The ultimate sanction against the Administrator would be a fine or ultimately a ban from index production, which in many cases would involve closing the business. It is therefore a severe threat.

26. What other measures outlined in the report, if any, should apply in addition to a code of conduct? If you believe a code of conduct, either on its own or in conjunction with other measures outlined within the report, would provide sufficient oversight to mitigate the risks that have been identified in Chapter 2, what type of code of conduct should apply (e.g., a voluntary code of conduct, an industry code of conduct submitted to and approved by the relevant Regulatory Authority, a code of conduct developed by IOSCO, etc.)?

Guidelines should be provided by IOSCO, then each Administrator would have to provide a suitable set of documents defining processes and protections, explaining how it is compliant with the Guidelines and where it is not, why compliance would not be appropriate. If the regulator wanted to see revisions to such processes at any time they could ask. If not then the
Administrator would then be responsible for the policing of itself and its Submitters and ensuring compliance.

27. Do you believe that the creation of a Self-Regulatory Organisation (e.g., one that exercises delegated governmental powers) and itself subject to governmental oversight, whether or not in conjunction with industry codes, is a viable alternative for sufficient oversight and enforcement to mitigate the risks that have been identified in Chapter 2? For which Benchmarks is this approach suitable? What if any complementary arrangements might be necessary, such as new statutory obligations or offences for Administrators and/or Submitters?

This is only slightly different from the preferred proposal set out above. Traditionally SROs have had delegated authority to manage an activity within a certain set of guidelines established by the overall regulator. Arguably an SRO regime would offer slightly tighter supervision but would be more costly than a pure guidelines system which allowed regulators to engage where they saw problems. An SRO system would in fact require routine and detailed supervision by the regulator.

28. Do you believe that for some Benchmarks reliance upon the power of securities and derivatives regulators to evaluate products that reference a Benchmark or exercise their market abuse or false reporting powers creates sufficient incentives for the Administrator to ensure sure that Submitters comply with a code of conduct?

Yes, but many benchmarks are used for important purposes outside the derivatives environment and even under the evolving regulatory regime (EMIR, MiFIR etc) not all derivatives will be clearly visible to regulators.

29. Do you believe that users of a Benchmark, specifically the users who are regulated or under the supervision of a national competent authority, should have a role in enhancing the quality of Benchmarks? Which form should this role take: on a voluntary basis (e.g., the user being issued a statement that will only use Benchmarks that follow IOSCO principles), or on a compulsory basis (e.g., the competent authority could request that users who are registered under their jurisdiction should only use Benchmarks that fulfil IOSCO principles)?

This is a difficult area. Users as the main customers (provided they are somehow contributing to the production costs) should have a substantial influence on the development of benchmarks and should have a view on standards. They should be engaged and consulted and should be represented on the supervisory committee.

However, the key driver for regulation and quality must be the relationship between regulator and Administrator. Users are very diverse in terms of business and geography and can only be engaged by the Administrator with whom they have a business relationship.

It is also important that bringing users too closely into the management process can lead to a further conflict of interest. Users, almost by definition, are invested in the market and would therefore like rates to be higher or lower. They must be kept at arms’ length from Submitters.

30. Do you agree that a Benchmark should be anchored by observable transactions entered into at arm’s length between buyers and sellers in order for it to function as a credible indicator of prices, rates or index values? How should Benchmarks that are otherwise anchored by bona-fide transactions deal with periods of illiquidity due to market stress or long-term disruption?

No, not always. This would not work in globalised, private markets such as shipping, where transactions are far from standardised and even apparently similar trades may not in fact be
comparable. An emphasis on observable transactions assumes that those observed are representative or a complete picture. This may well not be the case as many transactions may remain private. In many markets the size of the trade (especially large or small) may also be a distorting factor.

In shipping markets only a small proportion of trades become widely known, and this often some time later. They may become known because the trader wishes them to be known while keeping others secret.

31. Are there specific Benchmarks for which you consider that observable transactional data is not an appropriate criterion or the sole criterion? If so, please provide a description of such Benchmarks and what value you think such Benchmarks provide?

The Baltic Exchange benchmarks are not based on observable transactional data.

The shipping marketplace is arguably problematic from the point of view of benchmark production. Each vessel is different in some small or large degree. It may be a better or worse design from an efficiency point of view. It may be new or older tonnage which will have an impact on its attractiveness because of perceived risks and running costs. An owner may be seen as a high quality owner or a lower quality owner. The vessel or owner may have a good (or bad) record with record to Port State Control inspections and detentions. In addition, load ports and cargoes vary in terms of their desirability from the point of view of the owner, or their costs. Some cargoes are considered dangerous and high risk (eg Nickel Ore, which has a tendency to liquefy in certain circumstances) while other cargoes, such as grain, may be more appealing to owners.

The shipping marketplace is a private market. Owners and charterers usually negotiate through a broker for a transaction based on either a Voyage rate (a $/tonne rate for the shipment of the commodity) or a Timecharter rate (a $/day rate for the use of the ship). In each case both parties will consider what they know of available vessels and cargoes within the window of availability required (the Laycan) and will therefore make a determination as to the current commercial rate. Fixtures remain uncertain for a time as there are usually "subjects" to be resolved, ie matters outstanding which need confirmation, usually from the owner. This may for example be an issue of precise specification of the ship or the willingness of the owner to carry certain cargoes or load or discharge at certain ports.

Once a fixture has been fully finalised and subjects lifted, information about the transaction may become widely know in the marketplace. On the other hand it may not be disclosed since there is no obligation to do so and neither party may have an interest in disclosure. Equally the transaction may have been negotiated on the basis that it is P and C (Private and Confidential), in which case both parties and the broker(s) involved have an obligation not to disclose information.

In practice a considerable amount of reasonably accurate information does become generally available to the market. The Baltic Exchange publishes a daily fixture report summarising known information and also a daily market report, both covering the dry sector. However, there is no suggestion this represents complete information and there are occasions when it is not entirely accurate and may be corrected later. The tanker sector trades in a somewhat more standardised way with most business being fixed on a voyage basis and with relatively fewer participants the market may be considered somewhat more transparent.

It should also be understood that although it is important to provide the benchmarks at a specific time on a daily basis which are used for settling derivatives contracts and other benchmark-based transactions, not all routes will be fixed every day, or even have business quoted with any real reliability.
Thus the Baltic Exchange has developed a carefully defined methodology for the production of its benchmarks which reflects the difficulties in reporting this complex market and which exploits certain characteristics of it which allow for the production of credible and reliable indices on an impartial basis.

As explained above, in the international shipping market there is no reliable reporting of bids, offers and transactions, and such transactions take place on a truly global basis. More significantly, no two transactions can be considered to be identical. This is particularly in the timecharter market, but it remains true also in the voyage market.

The advantage in this matter which is enjoyed by the global shipping marketplace is the presence of truly independent, competitive, commission-earning brokers. Many persons in the shipping market will describe their profession as that of a shipbroker. A person working for a commodity house who is responsible for contracting the tonnage they require will call himself a shipbroker. Equally the representative of an owner, where working directly for the owner or in a separate but tied company, will also be a shipbroker.

However, the bulk of business is in the end transacted through intermediaries which are competitive shipbroking firms. These firms are paid purely on the basis of a commission for each transaction they negotiate. They do not invest in the market and therefore, critically, represent a neutral and independent source of information on the market. This situation may well be completely unique to shipping.

The Baltic prices its benchmarks only on the basis of contributions from a panel of competitive shipbrokers who are members of the Baltic Exchange and who agree to provide their professional assessments of the prevailing market rate each day at the time of submission. Baltic panellists are selected on the basis that they have specific expertise in the routes they report and are capable of making appropriate assessments of the prevailing open market rate, taking into consideration appropriate factors. Such factors would include available vessels and cargoes, current negotiations, recent fixtures (adjusted as appropriate to reflect the benchmark trip), market sentiment etc. We avoid using panellists who have a limited scope of business or are heavily reliant on a small number of clients and might therefore be subject to untoward influence. The panellist is guided by the Manual for Panellists which provides guidance as to factors which should or should not be considered in providing assessments.

For each route the Baltic creates and publishes a mathematic average of all of the submissions. The benefit of this process is the creation of reliable, independent benchmarks using inputs which are not conflicted but offer real market expertise.

32. What do you consider the limitations or value in Benchmarks referencing asset classes and underlying interests where there is limited liquidity? Please describe the uses and value of such Benchmarks in the financial markets.

Markets may be large and important and well able to sustain a derivatives market (which offers important hedging benefits to commercial participants), even though they are not in the conventional sense "liquid". Certain shipping routes will only trade (fix) a few times per week, though the market for a certain type of ship which trades those routes will be global and fixing many times per day. In this scenario the advantage of an effective benchmark production process is that it provides a degree of transparency which is unlikely otherwise to be present. It shines a light on an otherwise opaque market, to the benefit of the smaller trader who may not always be a true "insider".

The availability of benchmarks also allows the evolution of a derivatives market which can be very helpful in managing credit risk in the physical market (physical trades are traded on a floating rate then the fixed rate is obtained in the cleared derivatives market) as well as hedging of market risk in the usual way.
33. Do you agree that the greatest weight should be given to transactions in the construction of a Benchmark and that non-transactional information should be used as an adjunct (e.g., as a supplement) to transactions?

No, definitely not. See above.

34. What factors and how often should Administrators (or others) consider in determining whether the market for a current Benchmark’s underlying interest is no longer sufficiently robust? What effective methods of review could aid in determining the insufficiency of trading activity within the market for a Benchmark’s underlying interest?

There should be a continuous process of review. The benchmark Administrator must be responsible for ensuring that only valid benchmarks are produced and that where they can no longer be accurately and meaningfully generated they are closed down in an orderly fashion taking into account all outstanding contracts and open interest, and providing adequate notice of the change.

The best judges of the situation will be Submitters (at least where they are disinterested brokers), in conjunction with the Administrator and the users’ group.

35. What precautions by Benchmark Administrators, Submitters, and users can aid Benchmark resiliency during periods of market stress, mitigating the potential need for market transition?

The system should be designed in advance in totality. Changes made “on the fly” at times of market stress will not enhance confidence at what may be a difficult time. It should be clearly documented if there are alternative procedures for producing the benchmark which may be called upon in special circumstances.

36. What elements of a Benchmark “living will,” drafted by a Benchmark Administrator, should be prioritised?

The process for migration to a modified version of the benchmark is crucial. A benchmark which is no longer useful is probably not being traded and therefore will have little open interest in the derivatives market. On the other hand one which needs to be changed to stay in line with the evolving market may have substantial open interest and the establishment (in partnership with any clearing houses) of a clear and documented process for consultation and modification of the benchmark and consequentially settlement prices is highly desirable.

37. By what process, and in consultation with what bodies, should alternatives be determined for Benchmark replacement?

In consultation with users via the established channels. Commercial competition will also play a part and if a new provider offers a potentially better benchmark then this may be adopted by the industry on merit. There should not normally be outside intervention in these normal commercial processes.

38. What characteristics should be considered when determining an appropriate alternate Benchmark? (Examples below) Should any of these factors be prioritised?
The main driver for the adoption of an alternative benchmark should be market forces. It is difficult to see that this is an area where there could be any beneficial regulatory intervention.

39. What conditions are necessary to ensure a smooth transition between market Benchmarks?

There are two types of transition. In one an established market benchmark falls out of favour either because of its perceived quality or because of some other factor (time of publication, changes in underlying market, content etc). In this case contract and derivative interest will steadily decline until the provider no longer has sufficient customers to justify the costs. The process will be accelerated if a better alternative has appeared and is being adopted by the market. At this stage a major consideration will be the contractual relationship the Administrator of the failing benchmark has with users and a closure in line with contracts will presumably occur. In the second case the Administrator, working with the marketplace and Submitters realises that some change is needed. In this case the Administrator works with all interested parties and, taking into account his own and others' contractual position, makes a determination as to how to proceed. This is what happened in the case of RBOB.

40. What considerations should be made for legacy contracts that reference a Benchmark in transition? To what extent does a substantive legacy book preclude transition away from a Benchmark? What provisions can be included in [new and existing] contract specifications that would mitigate concerns if and when a Benchmark transitions occurs?

The Baltic Exchange has in the past carried out parallel runs of two benchmarks for fairly short periods (3 months) to establish a ratio between the old and new benchmark so that the new benchmark can be used to settle the old open interest. This can also facilitate parallel trading allowing all open interest in the old benchmark to be closed and re-opened in the new contract.

Such transition arrangements need to be agreed with clearing houses who are usually in a strong contractual position.

It would be helpful if transition arrangements for all contracts including derivative contracts were set out in the code of conduct, but there are risks to this in the sense that they may not cover the exact circumstances of the event, leading to potential litigation because the expected procedure could not be followed.

41. How should a timeframe be determined for market movement between a Benchmark and its replacement? What considerations should be made for:

- Altered regulatory oversight?
- Infrastructure development/modification?
- Revisions to currently established contracts referencing the previous Benchmark?
- Revisions to the Benchmark Administrator?
- Risk of contract frustration
It is both difficult and risky to be overly prescriptive in advance in this area. See 40. above.