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29 November 2012

European Commission
DG MARKT Unit 02
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Submitted via: MARKT-BENCHMARKS-CONSULTATIONS@ec.europa.eu

Re: **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**

Dear Sir/Madam:

Markit[1] is pleased to submit the following comments to the European Commission (the "***Commission***" or "***EC***") in response to its 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* (the "***Consultation Paper***" or the "***CP***").[2]

Introduction

Markit is a provider of financial information services to the global financial markets, offering independent data, valuations, risk analytics, and related services across regions, asset classes and financial instruments. Our products and services are used by a large number of market participants to reduce risk, increase transparency, and improve the operational efficiency in their financial markets activities. Markit is an index provider for various index families across regions and asset classes, including bonds, credit default swaps ("***CDS***") and loans. Markit administers and publishes the composition of all Markit indices and, separately, we act as the calculation agent for the iBoxx suite of bond indices and as an independent calculation agent for third-party index sponsors.

Markit has been actively and constructively engaged in the debate about regulatory reform of financial markets. Since the start of 2011, we have submitted over 40 comment letters to regulatory authorities around the world, and participated in numerous roundtables. We regularly provide the relevant authorities with our insights on current market practice, for example in relation to valuation methodologies, the provision of scenario analysis, and the use of reliable and secure means to provide daily marks. We have also advised regulatory authorities on appropriate approaches to enabling a timely and cost-effective implementation of newly established requirements, for example through the use of multi-layered phase-in or by providing participants with a choice of means for satisfying regulatory requirements.

Executive Summary

We welcome the publication of the Consultation Paper and we appreciate the opportunity to provide the Commission with our comments. Our comments focus first on the definitions of "index" and "benchmark" as these will be crucial parameters to ensure that the scope of any regulatory regime is appropriate. Thereafter, we provide responses to many of the Commission's questions.

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[1] Markit is a financial information services company with over 2,800 employees in Europe, North America, and Asia Pacific. The company provides independent data and valuations for financial products across all asset classes in order to reduce risk and improve operational efficiency. Please see www.markit.com for additional information.

[2] 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. 5 September 2012.

Comments

1. Scope of the regulatory regime

We believe that it is critically important for the Commission to define an appropriate scope for the regulation of benchmarks. Any regulatory regime applying to benchmarks should apply equally across all asset classes but should also be flexible enough to reflect the differences between them. While the CP contains a definition of "benchmark",[3] the terms "index" and "benchmark" are used almost interchangeably throughout the CP. We believe that such an interchangeable use combines two distinct products and use cases.

Specifically, we believe that a "benchmark" which would fall into the scope of the regulation should be defined as a contribution-based, calculated number, the purpose of which is to be explicitly referenced in financial instruments. In contrast, the term "index" would refer to a basket of instruments or constituents that is maintained by a set of rules. Of course, if such index serves as the basis for the calculation of a reference number that is a "benchmark" that calculation process may also be the subject of "benchmark" regulation. On that basis, we believe that the Commission, in its discussion of regulated products, should distinguish between the following categories:

- Category A: a composite price that is calculated based on a set methodology or formula, the purpose of which is to serve as a reference to determine the cash flows of financial contracts;[4]
- Category B: a defined set of instruments that is maintained by a set of rules, the purpose of which is to track the performance of an asset class or a market segment; and[5]
- Category C: a defined set of instruments that is maintained by a set of rules, the purpose of which is to serve as reference to determine the cash flows of financial contracts.[6]

Category A describes Libor-type instruments where the price for a *single* instrument is determined based on contributions. In contrast, Categories B and C describe *indices* that consist of multiple, often hundreds, of instruments where the pricing of these components might be determined based on contributions or in a variety of other ways. In order to ensure that a regulatory regime for benchmarks is proportionate and effective in achieving the regulatory objectives we believe that, across the various asset classes, Category A and, to the extent the calculation of the index value is a "benchmark," Category C should be regarded as areas for potential regulation by the Commission if the reference numbers that they provide are "widely referenced in financial contracts". Category B, i.e. indices that are produced to be used as performance benchmarks, should generally not be in scope. Further, any regulatory requirements should reflect that, given the large number of components that most indices are based upon, Category C products are only to a much more limited degree exposed to the challenges, e.g. the potential for manipulation, that have been observed for a Category A product such as Libor. In responding to the Commission's specific questions we refer back to these three categories and respond with these definitions in mind.

The CP defines "benchmark" as (a) "*any commercial index or published figure calculated by the application of a formula to the value of one or more underlying assets or prices, including estimated prices, interest rates or other values, or surveys*", (b) "*by reference to which the amount payable under a financial instrument is determined*."[7] We believe that this definition, while too broad in its reference to "any published

[3] 1.5 Defining Indices & Benchmarks, European Commission Consultation Document.
[4] An example of Category A would be the LIBOR fixings
[5] Examples include many fixed income benchmark indices such as the ones published by Barclays, Bank of America, Credit Suisse, S&P, Markit iBoxx and others on a daily basis.
[6] Examples include equity indices by S&P, FTSE, Eurex, and Topix, commodity indices published by RICI or S&P, fixed income indices from Barclays, S&P and Markit iBoxx, as well as Markit iTraxx and Markit CDX in CDS (to the extent that financial contracts are created based on them).
[7] 1.5 Defining Indices & Benchmarks, European Commission Consultation Document.

figure",[8] is largely appropriate as it describes those "benchmarks" that have been the source of recent concern, i.e. LIBOR-like instruments.

The first prong of the definition indicates that a necessary element of a benchmark is the calculation of a number or of a level. The second prong of the definition is equally relevant to describe a LIBOR-type instrument. However, the extent to which the various existing indices will be used to determine payouts of financial products differs significantly:

- Many indices and published figures are produced for informational purposes and are not intended to be used to determine payouts of financial contracts. For example, Markit's Purchasing Managers' Indices ("***PMIs***") are produced to provide the marketplace with an indication of economic growth expectations in various countries and are used by economists and the public for this purpose, similar to the US Consumer Price Index. Similarly, many Fixed Income indices are produced for use as performance attribution benchmarks by portfolio managers.
- Numerous other indices are, by their very nature, referenced in financial contracts only to a limited extent. For example, "bespoke" indices are created by index sponsors for the purpose of being referenced only by one or a small number of counterparties for specific transactions.[9]

On that basis, we believe that the most effective approach to regulating benchmarks will be for any regulatory regime to apply to those composite prices or index-based reference values across asset classes that are referenced *widely* in financial instruments.[10] In contrast, the large number of composite prices or indices that are not referenced at all or only to a limited extent should be outside the scope of this regulation.[11] Additionally, we believe that, for the determination whether a certain product would be regarded as a benchmark one would take into account its impact on the relevant financial products. Importantly, once a product that is provided by a specific index sponsor has been identified to be in scope of the regulation on the basis that it is "widely referenced", this categorization should apply also to all competing products in this category, even if they might not be as widely referenced at that point in time. Such approach will be necessary to avoid creating opportunities for regulatory arbitrage, as well as to secure a level and consistent playing field between index sponsors.

Finally, the Commission should note that, for the proper operation of an index, several distinct functions will need to be performed: the "index sponsor" sets the rules of the index, the "index administrator" is responsible for the application of these rules, while the "index calculation agent" will determine the value of the instrument. In practice, these roles might often be performed by different entities which, we believe, must be reflected in the design of any regulatory regime.

2. Responses to the Commission's questions

As we provide responses to the Commission's questions, we continue to use the definitions and categories that we have established in the previous section. We believe that this categorization is useful as it clearly delineates between indices, as a basket of instruments maintained by a set of rules, and indices that provide the basis for the calculation of a reference number that determines the payouts of financial instruments.

Question 1: Which BMs does your organisation produce or contribute data to?

[8] We believe that "any … published figure calculated by the application of a formula" would unintentionally capture many published numbers that would not typically be regarded as indices, for example the average monthly temperature or rainfall in the United Kingdom as published by the Met Office.

[9] Such indices or baskets are usually developed as part of a specific trading strategy and may have a fairly limited lifespan linked to the duration of the underlying transaction.

[10] As described in Category A above.

[11] As described in Categories B and C above.

Markit is the sponsor and administrator of the traded credit default swap ("***CDS***") indices Markit iTraxx and Markit CDX.[12] Importantly, our main role in relation to these indices is to determine, publish and maintain the *composition* of new index series based on a set of rules that are publicly available. However we are not a calculation agent as we do not determine or calculate any "official" index level or reference number that would be referenced in financial contracts.[13] We therefore believe that these indices are not benchmarks under the Commission's definition.

Further, Markit acts as the sponsor, administration and calculation agent for the suite of iBoxx bond indices.[14] In these roles we are responsible for the management and maintenance of the index rules, including the methodology for constituent selection, as well as the daily calculation and publication of the index levels. iBoxx indices are often used as tools for performance attribution, i.e. they are "benchmarks" in the traditional sense (Category B) and are not created for the purpose of serving as benchmarks referenced in a financial instrument (Category C).

Question 2

- **Which BMs does your organisation use? What do you use each of these benchmarks for? Has your organisation adopted different BMs recently and if so why?**

Markit uses various indices and composite prices calculated by other sponsors as inputs into our services such as valuations or pricing. For example, we will use Libor fixings to construct yield curves as an input; however the outputs of our calculations feed into valuations and risk assessments, not to determine cash flows of financial transactions. Importantly, the methodologies underlying our valuation calculations that use these indices and composite prices as an input are transparent and can be amended on clients' request. Specifically, clients will generally have the option to change the inputs that we use if they so desire. Additionally, Markit calculates indices from other entities and creates a transparent model around these calculations. The methodology and calculation framework is objective, and protected against interference or abuse, and is made available to clients.

Question 3: Have you recently launched a new BM or discontinued existing ones?

As an index provider we create new indices on an ongoing basis, often driven by specific client demand.

Questions 4 and 5

- **How many contracts are referenced to BMs in your sector? Which persons or entities use these contracts? And for which purposes?**
- **To what extent are these BMs used to price financial instruments? Please provide a list of benchmarks which are used for pricing financial instruments and if possible estimates of the notional value of financial instruments referenced to them.**

The Markit iTraxx and Markit CDX indices are amongst the most actively traded credit derivatives contracts globally.[15] However, Markit as the index sponsor does not presently calculate an index level that would

[12] We assume that the Commission referred to these indices as "CDS Index published by Markit".

[13] These indices consist of a specified number of Reference Entities who are the companies that are included in the index as constituents. Markit, in its role as administrator for these indices is responsible for determining the composition (i.e. component names) of new index series twice a year. CDS contracts referencing these baskets of names then trade in the marketplace at prices that are agreed individually between the counterparties. Importantly, the maintenance of the composition in the form of a publication of a new index series does not impact any outstanding transactions, i.e. it is not a "re-balancing" of the index. Methodologies determine its composition are publicly available and take into account corporate events, credit events, liquidity, debt outstanding, ratings and other relevant information.

[14] Markit iBoxx indices are fixed income indices. They are an essential performance attribution tool and provide data for fixed income research, asset allocation and performance evaluation in the global fixed income markets. Markit iBoxx indices are rebalanced monthly or quarterly on the last business day of the month after the close of business. These re-balancings eliminate the need to roll the index.

[15] Based on information available from the Trade Information Warehouse that is maintained by the Depository Trust and Clearing Corporation (DTCC), tradable credit default swaps based on Markit indices total USD $8 trillion notional and related tranches based on the same amount to almost USD $2 trillion.

determine the cash flows of financial products that reference the Markit iTraxx and Markit CDX baskets of Reference Entities.[16] They should therefore not be regarded as benchmarks (Category A) based on the Commission's definition.

iBoxx indices are most commonly used by portfolio managers and ETF issuers as tools for performance attribution.[17] Some asset managers and ETF providers have also created products that replicate or track the performance of the iBoxx indices. In case where this is achieved in "synthetic" format, the structuring entity may enter into derivative contracts that reference the level of the relevant Markit iBoxx index. Markit also recently facilitated the launch of Markit iBoxx Total Return Swaps ("***TRS***") for the most liquid market segments. The payouts of the TRS contracts that counterparties have entered into in some cases may be determined based on the daily Markit iBoxx levels that are calculated and published by Markit for these indices.[18]

Questions 30, 31, 32, 33, and 40

- **Is it possible and desirable to restrict the use of BMs? If so, how, and what are the associated costs and benefits? Please provide estimates.**
- **Should specific BMs be used for particular activities? By whom? Please provide examples.**
- **Should BMs developed for wholesale purposes be used in retail contracts such as mortgages? How should non-financial BMs used in financial contracts be controlled?**
- **Who should have the responsibility for ensuring that indices used as BMs are fit for purpose, the provider, the user (firms issuing contracts referenced to BMs), the trading venues or regulators?**
- **How do you consider that the adoption of new BMs could be ensured? Is this best framed in terms of encouraging or mandating the use of particular BMs?**

Based on today's licensing practices, index sponsors are generally not in a position to monitor and/or enforce restrictions on the specific use of their indices. In addition, many new benchmarks or indices are developed by smaller index sponsors that will often not be able to meet high regulatory standards and will, at the time of the index creation, not know whether the index will succeed and what the level of use or adoption will be. We therefore believe that the most effective manner of establishing regulatory requirements on the use of benchmarks would be by designing appropriate requirements for the regulated users of the products. For example, regulation might require UCITS ETF providers and/or investment firms structuring a product to reference only those benchmarks that satisfy specific requirements. We believe that such approach, which has been used also in the context of requirements for Financial Indices used by UCITS,[19] would be most effective and simple to implement.

Question 7: What factors do you consider to be the most important in choosing a reliable benchmark? Could you provide examples of benchmarks that incorporate these factors?

We believe the factors that are important in choosing a reliable benchmark are similar to the characteristics that are important in choosing an index. Our experience as a sponsor of various indices has shown that index users care most about the indices creating an accurate representation of the asset class in question. The index should also be based on a set of transparent and objective rules.[20] Further, benchmark levels that are described above as Category A should be calculated in a reliable and transparent manner, with a clear rule framework that is flexible enough to maintain these characteristics even in the case that market

[16] We believe that the term "used to price a financial product" is misleading and should not be used. This is because, in practice, market participants will use numerous inputs to price financial products without those necessarily being benchmarks.
[17] However, even if those users rely on the iBoxx *composition* as provided and updated by Markit, they will often replicate the *pricing* of the indices by use of their own internal price sources.
[18] iBoxx TRS are traded with standard maturities where buyer and a seller agree that in return for a quarterly fee the seller pays the percentage increase of the index over the lifetime of the product (or receives the percentage decrease).
[19] ESMA Guidelines on ETFs and other UCITS issues. 25 July 2012.
[20] The composition and calculation of Markit's indices are determined based on a transparent approach that is fully documented in the relevant index rules. For example, the iBoxx EUR High Yield Index Guide (https://products.markit.com/indices/download/products/guides/Markit_iBoxx_EURHY_Guide.pdf).

conditions change. We believe that attempting to regulate or require a specific manner of calculation or structure for a benchmark risks harming innovation and competition, and would also be less effective in preventing abuse than requirements for clear rules and transparency for the benchmark calculation methodology. The Commission should note that, while these principles apply to indices across all asset classes, they will be best achieved via the use of various means in order to reflect the differences between them. We believe that the Commission should also follow such approach when designing any regulatory requirements for benchmarks.

Questions 6, 8, 9, 10, and 11

- **How are BMs in your sector set? Are they based on real transactions, offered rates or quotes, tradable prices, panel submissions, samples? Please provide a description of the BM setting methodology.**
- **What kinds of data are used for the construction of the main indices used in your sector? Which benchmarks use actual data and which use a mixture of actual and estimated data?**
- **Do you consider that indices that do not use actual data have particular informational or other advantages over indices based on actual data?**
- **What do you consider are the advantages and disadvantages of using a mixture of actual transaction data and other data in a tiered approach?**
- **What do you consider are the costs and benefits of using actual transactions data for benchmarks in your sector? Please provide examples and estimates.**

The use of reliable and timely data for the valuation of an index is a critical element in the success of any index. Experience has shown that this objective can be more easily achieved in some asset classes, e.g. equities, where trading of the underlying index components occurs on a continuous basis, compared to other asset classes such as fixed income, where trading of the index components often happens only sporadically.

We agree that the use of transaction data can be helpful in improving the quality of indices and benchmarks. However, the Commission should note that transaction data will be most relevant in those asset classes where transactions do indeed occur for most of the underlying constituents on a regular basis and this data is available. In contrast, our experience in constructing and calculating indices for less liquid sectors of the financial markets has shown that, in many instances, the use of transaction data for the pricing of the index components will not be feasible and/or the reliability of this data is insufficient. We believe that generally, the decision which data sources a benchmark calculation should be based upon must therefore depend, amongst other factors, on the nature of the underlying market, whether transactions take place on a regular basis, whether post-trade price transparency is available, and the quality and usability of the various available data sources.

We believe that, given the relative lack of liquidity and availability of transaction data for many asset classes, benchmarks for those asset classes have to rely to a greater extent on data sources other than transaction prices and/or a mixed approach. For bond indices, for example, it is only through the use of evaluated bond prices or consensus prices that the consistent, objective, and timely valuation of each of the underlying components of indices can be achieved, even if transactions do not take place on a regular basis for many bonds. On that basis, we determine the daily levels for the various Markit iBoxx bond indices[21] based on multi-contributor pricing from market makers for the underlying bonds. We verify these contributed bond prices based on the close of business levels and other inputs to help ensure accuracy and will utilize best practices that have been established within each region.

We therefore believe that any requirements for benchmarks to prioritize the use of certain categories of data sources as inputs must be sufficiently flexible to allow sponsors to reflect the idiosyncrasies of the various asset classes and adjust to changes in market conditions where necessary. We also believe this flexibility is required to avoid stifling marketplace competition to create high quality and reliable products that do provide

[21] As explained above, Markit does not set any benchmark level for the iTRAXX and CDX traded CDS indices.

transparency even in illiquid markets. We believe that these objectives could be achieved, for example, by use of a waterfall approach, where sponsors were to draw mostly upon transaction data for liquid instruments while having the ability to use other data sources such as multi-contributor or evaluated pricing for the less liquid instruments.[22] Where judgements or estimates are used, for example because of the lack of transactions in the relevant instrument, they should be supported by relevant transactions or other reliable and observable data, depending upon what is available or best suited for this purpose. Markit uses best efforts to incorporate the most accurate prices and reliable data and we continuously refine our procedures to ensure their quality.

Question 15

- **Who in your sector submits data for inclusion in benchmarks? What are the current eligibility requirements for benchmarks' contributors?**

For index products, the decision which category of data the index calculation will be based upon will generally depend on the liquidity of the market. Compared to other asset classes, liquidity in the bond markets is fairly limited. Therefore, most bond indices can rely on transaction data only to a limited extent and will often have to be based on contributed pricing or a variety of alternative pricing sources. For Markit's iBoxx indices, we typically have commitment from up to 10 contributors, generally sell-side organizations that are market makers in the relevant markets, for the various index families. For the USD index products, pricing is currently derived from a variety of sources including end-of-day dealer contributions, and dealer quotes. We also make increasing use of evaluated bond prices, an approach that combines internal and external pricing sources, including TRACE transaction levels, with sophisticated pricing technology and specialist evaluators in order to produce accurate, transparent and timely pricing of the relevant bonds.

Questions 16, 17, 18, and 19

- **How should panels be chosen? Should safeguards be provided for the selection of panel members, and if so which safeguards?**
- **How should surveys of data used in BMs be performed? What safeguards are necessary to ensure the representativeness and integrity of data gathered in this way?**
- **What are the advantages and disadvantages of large panels? Even in the case of large panels could one panel member influence the BM?**
- **What would be the main advantages and disadvantages of auditing of panels? Please provide examples.**

We believe that the rules that govern participation in panels of contributors to benchmarks need to be transparent and result in panels that appropriately reflect the nature of the benchmark. As a general principle, for the various indices that we sponsor, we work to ensure that contributor panels include all active market makers in the underlying products.

Importantly, our experience has shown that increasing the size of a panel per se does not automatically improve the quality of an index, and sometimes might have the opposite effect.[23] We believe that the decision whether the panel that is employed for the creation of a specific benchmark should be large or small very much depends on the number of parties that are active in the underlying market. Also, the decision whether further contributors should be added to a given panel should depend on whether some firms that are not panel members at the moment are likely to contribute accurate and knowledgeable information about the current pricing. Finally, the optimal size of the panel will not be static. It will be important to review panel membership on a regular basis in order to reflect changes in the relevance and activity of the contributors.

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[22] Such approach would provide (a) quality assurance and resilience, (b) the ability to create benchmarks also for the less liquid asset classes and products, and (c) a better reflection of where the market, rather than one market participant, is trading.

[23] Simply adding further contributors to a panel will often result in reducing the quality of the resulting index, not improving it. For example, for a product with only 5 active market makers, the goal of the index sponsor should be to encourage those 5 firms to contribute to the service. Adding a further 5 contributors that are not market makers and do not follow the market on an ongoing basis will only add noise to the composite price and reduce its quality and informational content.

Questions 20, 21, and 22

- **Where indices rely on voluntary contributions, do you consider that there are factors which may discourage the making of these contributions and if so why?**
- **What do you consider to be the advantages and disadvantages of mandatory reporting of data?**
- **For entities contributing to BMs which are regulated by financial regulation, what would be the advantages and disadvantages of bringing their BM submissions under the scope of this framework?**

Benchmark sponsors that rely on regular contributions from firms for the benchmark construction and/or calculation need to establish frameworks that create incentives both to contribute data and to ensure that their contributions are accurate. Our experience is that there are several mechanisms that can be used to help advance this balance, but not one set of rules that will work in all cases. We believe that, in this context, the Commission should note that excessive regulation and imposing overly burdensome requirements on contributors presents significant risk of discouraging them to contribute. This would have the negative side effect of reducing not only the quality of available benchmarks but also potentially their number, and would hence reduce transparency in the marketplace. Any regulation of benchmarks should not be unnecessarily burdensome to reflect this risk and should not create a framework that discourages participation in contributing to benchmarks that can provide transparency even in asset classes that are illiquid.

Questions 23, 24, 25, 26, 27, 28, and 29

- **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?**
- **What is the formal process that you use to audit the submissions and calculations?**
- **If there are any weaknesses identified in the audit, who are they reported to and how are they addressed? Is there a follow up process in place?**
- **How often are submissions audited, internally or externally and by what means? Do you consider the current audit controls are sufficient? What additional validation procedures would you suggest?**
- **What are the advantages and disadvantages of a validation procedure?**
- **Who should have the responsibility for auditing contributed data, the index provider or an independent auditor or supervisor?**
- **What are the advantages and disadvantages of making BMs a regulated activity?**

a) Quality assurance and adjustments

Index sponsors will typically have responsibility for the administration of an index, such as the publication and maintenance of the relevant rules and the execution of index rolls and re-balancings[24] as well as for the daily calculation of index levels (depending on the structure of the underlying market and whether the index sponsor acts as a calculation agent). On that basis they should also drive any adjustments in consultation with the relevant oversight committees.

The processes of Markit Indices are subject to monthly Key Performance Indicator (KPI) metrics that are presented to and assessed by our management team. Potential deficiencies are addressed as part of our issue resolution and management policy. The efficiency of our index compilation and publishing procedures is also measured against client feedback as well as the number of complaints and issue escalation.

Any challenges and questions in relation to our indices can be submitted via well-managed and tracked email/telephone contact points that are available on our website. Queries that are submitted in this manner

[24] For a detailed description of the iBoxx bond price contribution process please see http://www.markit.com/assets/en/docs/products/data/indices/bond-indices/iboxx-rules/documentation/Markit%20iBoxx%20Bond%20Price%20Consolidation%20Rules.pdf

will be recorded in our system by our client support team and will be escalated to the appropriate department or team for review. Should there be a need to make amendments to any components of the index, the issue will be raised to the appropriate index committee to solicit feedback and proceed accordingly as per the index rules.

b) Contributor relationship

As calculation agent for the iBoxx indices we require market makers to contribute bond prices to ensure that the calculation of the iBoxx index levels can occur on a daily basis. This requirement had to be established given the lack of price transparency in the European fixed income markets and the insufficient depth of trade data in the US fixed income markets. Depending on the index family, Markit requires market makers to submit quality bond prices on a daily or more frequent basis. We will then apply a number of cleaning tests to the contributed dataset[25] and will also compare it to externally available data sources.

As part of our standard process, we are also in regular contact with the iBoxx contributors and provide them with feedback on the quality of their submissions in an effort to ensure a high quality of their contributions. This communication is facilitated by the provision of weekly and monthly data quality reports and regular management review meetings.

Lastly, Markit's agreements prescribe technical standards that contributor firms are expected to conform to when submitting their data to us. Such technical standards have been designed to ensure the uniformity of data and to minimise technical or computational errors that may lead to the submission of an incorrect dataset to Markit.

Questions 12, 13 and 14

- **What specific transparency and governance arrangements are necessary to ensure the integrity of BMs?**
- **What are the advantages and disadvantages of imposing governance and transparency requirements through regulation or self-regulation?**
- **What are the advantages and disadvantages of making contributing data or estimates to produce BMs a regulated activity?**

In addition to accurate and timely valuation data, sufficient transparency and an appropriate governance structure are further key success factors for both indices and benchmarks.

Markit's index division, as part of our overall financial information and services business, acts as the administration and/or calculation agent for indices where Markit is the index sponsor, but also for 3rd party indices. Markit's index businesses have always been part of our overall financial information and services business. We believe that, leaving physical presence (location) and accounting standards aside, there is limited need for Markit's index business to operate out of a separate legal entity. This is because we are not exposed to conflicts of interest (or the potential for those) that would arise if we were to offer also execution and/or clearing services or the pricing of our indices was to rely mostly on our own contributions.

Our experience in managing various indices across asset classes has shown that, to be effective, the design of any index governance arrangement must take into account a) the nature and purpose of the index, b) the liquidity and transparency of the underlying market, c) the role of the index sponsor[26] and d) the expertise of the user base. Markit's index committee structure is set up to reflect these factors by asset class and index family. This structure is transparent and well documented in the published rules of each index family. We believe this structure will also help to create successful benchmarks.

[25] *Id.*
[26] For example, the calculation agent vs. administrator.

Each of Markit's cash bond index families has an Index Oversight Committee ("***IOC***") and a Technical Committee ("***TC***"). The IOCs act as formal bodies that are largely comprised of asset managers, consultants and, where relevant, local regulators. Their role is to provide advice to the index sponsor with regards to the development of the iBoxx indices and related products. The objective of these consultations is to assist in the creation of highest quality standards for the indices and to ensure that they are upheld by Markit and all other parties associated with the cash bond index production. Specifically, the iBoxx IOCs will advise Markit with regard to the quality of index calculations, the definition or revision of index rules, the creation of new indices, products and services, and improvements to existing indices, products and services. While participation in the IOCs varies between index family and local market requirements they will, on average, consist of 10 members. IOCs will generally meet at least once a year and also ad hoc whenever necessary. Decisions of the IOCs are made publicly available on our website as an announcement.[27]

The TCs advise Markit with regard to the monthly index rebalancings, the definition or revision of index rules, the creation of new indices, improvements to existing indices, and additional analytical values for calculation or publication. TCs typically meet either monthly or once a year and on an ad-hoc basis where necessary.

Markit's traded CDS indices, Markit iTraxx and Markit CDX, have a number of index-specific product committees that are mostly comprised of market makers. These product committees will advise Markit around the creation of and changes to the transparent set of rules that govern the administration of these indices. Although solicited, and provided for in, for example, our iTraxx Committee Terms of Reference, we have not seen any notable interest from buy side participants in active index committee participation. Markit aims to ensure alignment of its index business with the wider market by participating in the ISDA Credit Steering Committee (CSC) and the ISDA Credit Implementation Group (CIG) discussions, whose voting members include most significant market participants.[28]

Questions 34, 35, 36, 37, 38, and 39

- **Do you consider some or all indices to be public goods?**
- **Which role do you think public institutions should play in governance and provision of BMs?**
- **What do you consider to be the advantages and disadvantages of the provision of indices by public bodies?**
- **Which indices, if any, would be best provided by public bodies?**
- **What conflicts of interest would arise in the provision of indices by public bodies? What would be the best way of avoiding these conflicts of interest?**
- **What are the likely transition challenges, costs and timelines for relevant BMs?**

We believe that some public sector involvement in the creation of benchmarks may be useful, for example in form of regulatory oversight of the LIBOR mechanism.[29] However, as a general principle, we strongly believe that the creation and administration of indices and benchmarks is best performed as a private sector activity as to ensure that innovations continue to occur, it remains competitive and the highest quality products are made available to the market.

We agree that conflicts of interest can be an issue in relation to benchmarks and we agree that these should be either avoided or, where they cannot be avoided, addressed by requiring the implementation of appropriate policies and procedures. However, we believe that it would be wrong to assume that the provision of benchmarks by public bodies would avoid these issues. In contrast, we believe that such approach is likely to result in creating other problems, for example because these bodies generally have

[27] http://www.markit.com/en/products/data/indices/updates/news.page?dcr=/markit/IndicesNews/data/2012/09/01-01.

[28] Non-voting members include Markit, other vendors such as Bloomberg, Tri-Optima, ICE, LCH.Clearnet, and CME.

[29] "The new administration should fulfil specific obligations as part of its governance and oversight of the rate, having due regard to transparency and fair and non-discriminatory access to the benchmark. These obligations will include surveillance and scrutiny of submissions, publication of a statistical digest of rate submissions, and periodic reviews addressing the issue of whether LIBOR continues to meet market needs effectively and credibly." The Wheatley Review of LIBOR: Final Report.

little incentive to ensure the usefulness of the indices they create and/or securing the accuracy of the index data. In contrast, commercial benchmark providers will only succeed in creating commercially viable products if they manage to provide accurate and reliable data, establish appropriate governance structures, and provide sufficient transparency around their methodologies and data inputs. Finally, the Commission should take into account that some of the Libor-related problems might have arisen because this benchmark was in fact *not* administered by a commercial entity.[30]

Implementation and expected impact

Questions 41, 42, and 43

- **How can reforms of the regulation of BMs be most easily implemented?**
- **What positive or negative impacts, if any, do you see on small and medium-sized enterprises of the possible regulation of indices, and how could any negative impacts be mitigated?**
- **Are there other impacts which should be considered? If so please specify the nature of these impacts and provide evidence.**

As we explained in more detail above, we believe that any regulation of benchmarks should apply to those reference number calculations that are widely referenced to determine payouts of financial instruments and have systemic relevance. Such a targeted approach would also enable a timely implementation and avoid the creation of any unnecessary cost.

We also urge the Commission to consider that extensive regulation and restrictive measures on the creation of benchmarks risks creating significant disincentives to contributors that can provide valuable pricing inputs in illiquid markets. This must be a significant consideration because contributed prices are sometimes the best or only means to accurately gauge the value of a particularly security. If no active transactional market exists for a particular financial product excessive regulation might inadvertently harm innovation and prevent the creation of useful indices that provide transparency to the marketplace and rely on such inputs.

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Markit appreciates the opportunity to comment on the European Commission's 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.* We would be happy to elaborate or further discuss any of the points addressed above. In the event you may have any questions, please do not hesitate to contact the undersigned or Marcus Schüler at marcus.schueler@markit.com.

Yours sincerely,

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[30] Specifically, it could have been one of the reasons why the process of the benchmark creation and calculation was not exposed to the necessary scrutiny.