

16 January 2013

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Financial Services Authority
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Submitted via: cp12_36@fsa.gov.uk

Re: **The regulation and supervision of benchmarks**

Dear Sir/Madam:

Markit¹ is pleased to submit the following comments to the Financial Services Authority (the “**FSA**”) in response to its Consultation Paper on *The regulation and supervision of benchmarks* (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 and loans. We also administer and publish the composition of all Markit indices and, separately, 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 discussion regarding regulatory reform of financial markets. We regularly provide regulatory 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 bodies on potential approaches to enable 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. Over the last two years, we have submitted over 40 comment letters to regulatory authorities around the world, and participated in numerous roundtables. In the context of the discussion regarding the regulation of benchmarks and indices we have submitted responses to the *Wheatley Review*³ as well as to the European Commission’s *Consultation Document on the Regulation of Indices*.⁴

¹Markit is a financial information services company with over 2,900 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 FSA: The regulation and supervision of benchmarks. December 2012.

³ The Wheatley Review of LIBOR: initial discussion paper. Markit letter to the HMT regarding the initial discussion paper (07 September 2012) [available here](#).

⁴ 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. Markit letter to the European Commission regarding the consultation document (29 November 2012) [available here](#).

Executive Summary

We appreciate the opportunity to provide the FSA with our comments on the Consultation Paper. Below, we provide our views on the FSA's general approach on assigning responsibilities to the Benchmark Administrator ("**BMA**"), the Oversight Committee ("**OC**") and the Benchmark Submitters, as well as the BMA's potential revenue model, followed by responses to the FSA's specific questions.

1. The roles of Benchmark Administrator, Oversight Committee, and Benchmark Submitters

Given the range of tasks that have been assigned to the Benchmark Administrator, we believe the most effective administration of a benchmark may be achieved by having several, specialized entities operate in tandem. Accordingly, we support the FSA's acknowledgment that the "functions of an administrator may be carried out by more than one entity."⁵ We also believe the FSA should permit a BMA to outsource one, or several, functions of more limited scope to other parties. In this circumstance, the BMA would be the regulated entity and would remain responsible for the activities that it outsources.

We are generally supportive of the described requirements that the CP sets out for the BMA, including the implementation of credible governance and oversight, the creation of a code of practice and the performance of regular, periodic reviews of the setting.⁶ In addition, we offer the following views in relation to the FSA's approach on which parties will have responsibility for certain functions:

- We agree that the BMA should be responsible for identifying breaches of practice standards and for notifying the FCA when it suspects attempted manipulation of the benchmark.⁷ We also believe that, to help a BMA in its function and to enhance the integrity of the benchmark, the BMA's function should include mechanisms that help ensure the accuracy of individual benchmark submissions. This would give BMAs the ability to go beyond simple aggregation of submissions and to perform some validation and testing of individual data points.
- The CP proposes holding the Oversight Committee responsible for creating the definition and scope of the benchmark and to exercise "collective scrutiny of individual submissions".⁸ In contrast, we believe that the BMA⁹ should play the leading role in respect of developing definition and scope of the benchmark. We believe that, in general, indices and benchmarks are commercial products where the index sponsor takes responsibility for developing them according to clients' needs and best practices. The natural incentives in this regard should be maintained. Making decisions regarding definition and scope on the OC level risks being untimely or based on compromises (as opposed to a defined commercial purpose). Accordingly, we believe that the FSA should allow this function to be performed by the BMA, with disclosure to and, as appropriate, oversight by the OC. We also believe that the BMA will most often be in the best position to identify concerns on individual submissions as it is the entity that performs the day-to-day data cleansing and that has the strongest economic interest in securing the accuracy of the data. While the BMA should present specific, relevant cases of data issues to the OC for further discussion where necessary, we believe that these should be limited to those cases that are of a more structural or difficult to address nature.

2. Cost benefit analysis and the BMA's revenue model

We appreciate the cost benefit analysis that the FSA has performed for the BMA and the benchmark submitters.¹⁰ The FSA has identified significant costs that will arise to the BMA (and the benchmark submitters), but it has not identified (or quantified) the relevant sources of the BMA's revenues. We believe

⁵ "Benchmark rules: administrator." FSA: Regulation and supervision of benchmarks.

⁶ "Benchmark rules: administration." FSA: Regulation and supervision of benchmarks.

⁷ Section 1.12 FSA: Regulation and supervision of benchmarks.

⁸ Section 2.11 FSA: Regulation and supervision of benchmarks.

⁹ In today's framework it would be the benchmark sponsor.

¹⁰ Annex 1: Cost benefit analysis. FSA: Regulation and supervision of benchmarks.

that, given the heightened scrutiny that will be imposed on the benchmark process and the BMA's activity, potential BMAs may well find it challenging to identify a viable business model that would allow them to generate sufficient revenues to operate the benchmark process, establish the required governance structures, pay for their oversight, and produce adequate transparency. We therefore encourage the FSA to further discuss this issue with potential BMAs.

3. Responses to specific CP questions

Please find below our answers to the specific questions that the FSA asked in the CP.

Q1: Do you agree that our suggested capital requirements for the administrator will give enough time for an orderly transition to a new administrator?

The CP contains some prudential rules for the BMA, including a requirement for it to hold an amount of capital that is sufficient to secure business continuity and allow for an orderly transition to a new BMA.¹¹ Specifically, the BMA would be required to hold capital to cover its operating costs for a period of 6 months plus a buffer for a further 3 months.

We understand the FSA's desire to ensure the continuity of the benchmark and think it reasonable, in the case of LIBOR, that a period of 6 months should suffice for finding a replacement for an existing BMA.¹²

Regardless of the amount of capital required, the FSA should specify the required form of financial resources to allow potential BMAs to quantify the expected cost that will arise from this requirement. We believe that BMA's should be allowed to hold the required amount either in form of cash, liquid and high quality securities, or credit lines, as well as bank guarantees or insurance.

Q2: Are there any other rules that we should consider for the administrator?

As explained in more detail above, we believe that the FSA should consider a broader opportunity for the BMA to help ensure that individual benchmark submissions it receives are appropriate in the context of the data points available to the benchmark submitter, the market for this instrument, other relevant values, and between submitters.

In addition, we urge the FSA to provide greater clarity on the following BMA-related requirements in order to better define the role and responsibility of the BMA and add certainty to the benchmark process:

- The CP states that BMAs would be required to “corroborate submissions and monitor for any suspicious activities.”¹³ We believe that such requirement should be limited to procedures that have been agreed-upon between the FSA and the BMA. Further, the task should be performed on a “best efforts” basis with the BMA not being liable for the integrity of the submissions, except in cases of fraud by the BMA or in cases of collusion between the BMA and other relevant parties. Specific limitation of liability for the BMA will be essential to allow the BMA to perform its role without fear of catastrophic liability for inappropriate activity by others.
- The BMA would be required to “corroborate the submissions of individual submitters, identify breaches of submission practice standards, and notify the FCA when it suspects attempted or actual

¹¹ Section 2.16. FSA: Regulation and supervision of benchmarks.

¹² This conclusion is based on our view that several providers possess the required operational capabilities to act as BMA and that, once the code of practice and the relevant contribution procedures have been established, they can continue to be used regardless of any changes to the BMA. Consequently, the major issues to be addressed during a transition period would be the process of choosing the new BMA and benchmark submitters switching their data feeds to it once it has been chosen. We believe that these tasks could be completed within a period of up to 6 months.

¹³ The rules governing LIBOR. FSA: Regulation and supervision of benchmarks.

manipulation.”¹⁴ We believe that, in this context, there should be differentiation between factual submissions (e.g., actual trade, volume and price levels), and subjective submissions that might be required in the case of illiquid markets and the absence of real transaction data. While it will be more challenging for the BMA to monitor and control the influence of manipulation for subjective submissions, we believe that allowing the use of a range of types of inputs into the benchmark determination will benefit the benchmark process.

- We urge the FSA to provide further clarification on how adjustments to fix any potential errors should be handled.¹⁵ For example, would any published LIBOR fixings be restated, or, once a material error had been identified, would future LIBOR fixings be adjusted immediately and would this require an approval by the Oversight Committee? Additionally, how would the FCA expect this flow of market sensitive information to be best managed?

Q3: Do you agree with our proposals for charging fees from the benchmark administrator?

As stated above we believe that the FSA should, in dialogue with potential BMAs, perform further analysis regarding a BMA’s ability to generate sufficient revenue and determine whether it would, overall, result in a commercially reasonable proposition. The fee charged by the FSA for supervision of the BMA will certainly play a role in this context.

Regardless of the actual amount of the fee, we believe that further clarification on its details is needed. For example, would such fee be the same for firms that are “currently unauthorized” and those that are “already authorized for another regulated activity?” Given that the independence of the BMA is a key concern in this process, we believe that the FSA’s fee structure should create a level playing field and entities that are already registered to perform this service should not be provided with an advantage vis-a-vis those that are not.

Q4: Do you think there are any other rules we should consider for the submitters?

We recommend that the FSA provides clarification on the following issues in relation to the submitters/submissions:

- Depending upon the scope of products ultimately subject to these regulations, it may be necessary to include a variety of inputs to ensure the quality of benchmarks across a wide range of products, submitters, and market conditions. The FSA should therefore not limit benchmark submissions only to those that are based on “objective criteria”¹⁶ but also allow submissions based on “subjective” criteria, as long as their production is subject to appropriate disclosure, diligence, oversight, governance and record keeping. As long as BMAs are given the ability to obtain all relevant underlying data and information to allow the validation of an individual submission, it should be a permitted input.
- The FSA should clarify the limits of “restraining the ability of any person, including senior management, to exercise inappropriate influence over the daily submission.”¹⁷ We believe that a management override may present a significant risk in the prevention and detection of fraud, in particular where there is a degree of subjectivity in a submission.

¹⁴ Benchmark rules: administrator. FSA: Regulation and supervision of benchmarks.

¹⁵ “The administrator would use this monitoring capability to observe the behavior of benchmark submitters and identify potential instances of benchmark manipulation or breaches of its practice standards. We would expect the administrator to have an initial, internal process of identification, leading to a process of escalation to the FCA.” Benchmark rules: administrator. FSA: Regulation and supervision of benchmarks.

¹⁶ Benchmark rules: submission. FSA: Regulation and supervision of benchmarks.

¹⁷ Benchmark rules: submission. FSA: Regulation and supervision of benchmarks.

Q5: For what period should submitters be mandated to keep records?

We believe that records of benchmark submissions as well as the relevant data inputs underlying such submissions should be retained for six years from the publishing date of the resulting benchmark. This would be consistent with existing legislation.¹⁸

Q6: How frequently do you think the external audits should occur?

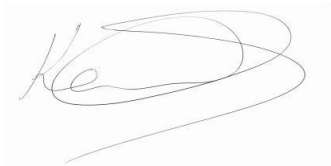
Service audits such as SSAE 16¹⁹ are typically issued at a specific point in time to cover a period of six or twelve months. On that basis we would recommend for audit reports on contributions to or production of benchmarks to be performed annually based on data samples from the previous twelve months to provide assurances about a firm's compliance with the relevant rules.

Additionally, given the weight that the FSA places on the code of practice, compliance with this code should be included in the scope of the external audit.

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Markit appreciates the opportunity to comment on the FSA's Consultation Paper on *The regulation and supervision of benchmarks*. 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 Schöler at marcus.schueler@markit.com.

Yours sincerely,



Kevin Gould
President
Markit

¹⁸ Limitation Act 1980, s. 5.

¹⁹ Statements on Standards for Attestation Engagements No. 16 Reporting on Controls at a Service Organization.