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16 May 2013

Mr. Alp Eroglu
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

Submitted to BenchmarkPrinciplesconsultationresponses@IOSCO.org

Re: **Principles for Financial Benchmarks**

Dear Sir/Madam:

Markit[1] is pleased to submit the following comments to the International Organization of Securities Commissions ("***IOSCO***") in response to its Consultation Report on *Principles for Financial Benchmarks* (the "***Consultation Report***" or the "***CR***").[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 administer and publish the composition of all Markit indices and also calculate the levels of the Markit iBoxx suite of bond indices and other third-party indices.

Markit has been actively and constructively engaged in the discussion regarding regulatory reform of the 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 the 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 several years, we have submitted over 80 comment letters[3] to regulatory authorities around the world and participated in numerous stakeholder meetings.

In the context of the discussion regarding the regulation of benchmarks and indices, Markit has submitted responses to HMT's *Wheatley Review,*[4] the FSA's *Consultation Paper on the regulation and supervision of benchmarks*,[5] the European Commission's *Consultation Document on the Regulation of Indices*[6] and

[1]Markit 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] IOSCO Consultation Report: Principles for Financial Benchmarks. April 2013.
[3] This number includes responses submitted by MarkitSERV, a now fully-owned subsidiary of Markit Group.
[4] The Wheatley Review of LIBOR: initial discussion paper. Markit letter to HMT regarding the initial discussion paper (07 September 2012) *available* here.
[5] FSA Consultation Paper: The regulation and supervision of benchmarks. Markit letter to the FSA regarding consultation paper (16 January 2013) *available* here

IOSCO's *Consultation Report on Financial Benchmarks*[7] and ICAEW's *Exposure Draft and Interim Guidance for the Performance of Assurance Work on Benchmark and Indices.*[8]

Executive Summary

Financial Benchmarks ("***BMs***") and indices are products that have built a long established history of providing transparency and liquidity to the financial markets, including for less liquid market segments. These benefits have been recognized by market participants and also by various regulatory authorities that have approached index providers over the years with a desire to increase the transparency, liquidity, and tradability of their local markets by creating indices for them. Indices and benchmarks have a history of providing many benefits to market participants and the public, contribute to making financial markets more efficient and liquid, fostering a sound basis to provide financing that drives economic growth.

The recent Libor-related events have put BMs into the spotlight and caused the marketplace and regulators to re-examine these instruments. We agree that the underlying facts of any manipulation of Libor or other BMs should be investigated and failings of the existing mechanisms identified and addressed. At the same time, we would caution that, given the multitude of products that could potentially be regarded as BMs, any regulatory approach must be proportionate to enable a timely implementation of trust-restoring requirements for the most exposed, Libor-type benchmarks while not causing unintended consequences for the broader market of BMs and indices. Specifically, we believe that regulators need to clearly distinguish between Libor-type BMs, other BMs, indices, and other products that might be in the scope of the BM definition used, given the significant differences that exist between them.

We commend IOSCO for publishing such a comprehensive Consultation Report on BMs and for outlining alternative policy options in regards to the appropriate level of regulatory oversight, the relevant standards for calculation, credible governance structures to address conflicts of interest, and the appropriate level of transparency and openness in the benchmarking process. We believe that many commercial providers of BMs and indices are aware of most of these issues already today and, in many cases, address them through use of appropriate means. We appreciate the opportunity to provide IOSCO with our comments and responses.

General questions and comments

a) Scope and calibration

We strongly support IOSCO's commitment to creating a proportionate regime for the regulation of BMs.[9] However, we note that IOSCO's proposed definition of BM[10] is extremely wide and could easily capture

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[6] 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.

[7] IOSCO Consultation Report: Financial Benchmarks. January 2013. Markit letter to IOSCO regarding the consultation report (11 Feb. 2013) *available* here.

[8] ICAEW Technical Rules: Exposure Draft and Interim Guidance for the Performance of Assurance Work on Benchmarks and Indices. Markit letter to ICAEW regarding the Technical Rules (09 April 2012) *available* here.

[9] IOSCO CR Principle 12: Transition.

[10] "The BMs in scope of this report are prices, estimates, rates, indices or values that are: a) Made available to users, whether free of charge or for payment; b) Calculated periodically, entirely or partially by the application of a formula or another method of calculation to, or an assessment of, the value of one or more underlying Interests; c) Used for reference for purposes that include one or more of the following: (i) determining the interest payable, or other sums due, under loan agreements or under other financial contracts or instruments; (ii) determining the price at which a financial instrument may be bought or sold or traded or redeemed, or the value of a financial instrument; and/or (iii) measuring the performance of a financial instrument." IOSCO CR Annex A: Glossary of Key Terms.

almost any number that has some relevance in financial markets.[11] We therefore reiterate the many benefits of using a more tailored and specific definition of BM.[12]

We further believe that the proportionality that IOSCO has embedded in its Principles is quite limited.[13] It will therefore be crucial for any national regulatory authorities that make their policy decisions on the regulation of BMs[14] on the basis of IOSCO's Principles to set an appropriate scope and/or carefully calibrate any regulatory requirements for BMs in their jurisdiction taking into account the relevant product characteristics.

We agree with IOSCO that, to achieve the objective of a regulatory regime for BMs that is proportionate and appropriate, national regulators make use of IOSCO's concept of factors[15] to draw regulatory distinctions. Specifically, we recommend the use of the following factors for this purpose:[16]

- Systemic importance of the BM
    - The extent to which a BM is widely referenced in financial instruments[17] and/or it has a significant economic impact through other channels.
- The BM's susceptibility to manipulation
    - The susceptibility of the BM to conflicts of interest; and the ability of and incentives for the various parties that are involved in the benchmarking process to manipulate the BM.
    - For example, given the large number of components that most indices are based upon, they will only to a much more limited degree be exposed to the risk of being manipulated in contrast to LIBOR-type BMs that only contain one single variable that is determined based on a handful of contributions.
- Availability of alternatives to the BM
    - The availability of other, competing BMs that serve as close substitutes and the ability of users to switch to those alternative BMs if they so desire.
- The BM's compliance with current standards
    - Whether the BM and the parties that are involved in the benchmarking process already comply with a Code of Conduct based on market forces.
    - Whether and to what extent the BM and the parties that are involved in the benchmarking process are already subject to regulatory oversight.[18]

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[11] For example, many market participants might use the average temperature in a certain region by as input into determining the value of a financial contract referencing soft commodities.

[12] As we explained in more detail in our previous response to IOSCO, we believe that the use of the following, more targeted definition of BM would provide several benefits: "A commercial or published composite price assessment, distributed regularly to the public and widely used as a reference price in determining the amount payable pursuant to financial instruments or contracts that are material in size and scope." By using such definition IOSCO could ensure that any regulatory requirements would focus on those BMs that have a Libor-type nature and systemic importance.

[13] IOSCO recommends that the BM Administrator develop consultation procedures that are "appropriate and proportionate to the breadth and depth of Benchmark use and the nature of the Stakeholders for changes to its methodology." IOSCO CR Principle 11: Changes to Methodology. Additionally, IOSCO recommends that policies and procedures relating to transition should be "proportionate to the estimated breadth and depth of contracts and financial instruments that reference a Benchmark and the economic and financial stability impact that might result from the cessation of the Benchmark." IOSCO CR Principle 12: Transitions.

[14] However, we question the effectiveness of a national approach for the regulation of BMs as explained in more detail below under c) Implementation.

[15] "IOSCO members should encourage implementation of the principles including through regulatory action where appropriate … The factors discussed in the January 2013 Consultation Report on drawing regulatory distinction are also pertinent to this inquiry." IOSCO CR: Chapter 1, Implementation.

[16] Most of these factors are based on those that were previously proposed by IOSCO. IOSCO Consultation Report: Financial Benchmarks. January 2013.

[17] Regulators might want to assign specific attention to the fact whether and to what extent the BM is referenced in exchange-traded products.

[18] While we believe that IOSCO should consider this factor to some extent, e.g. for setting priorities, it should ultimately aim to treat all relevant entities equally, regardless of whether they are regulated entities or not. This view was also reflected by IOSCO, when it stated that "Although the submission and/or compilation of some of the Benchmarks considered by the Task Force is performed by regulated firms, the specific acts of submission and Benchmark compilation do not appear to be directly covered by the relevant regulatory framework." and "IOSCO member jurisdictions generally have enforcement authority in relation to Benchmark setting

We believe that, by applying the above factors to the various products in question, regulators can effectively differentiate between Libor-type BMs, other BMs that are not exposed to the same risks or of similar systemic importance, indices[19] and other numbers that might otherwise unintentionally be captured by IOSCO's BM definition, and guide their policy decisions accordingly.

b) Submission-based BMs

While IOSCO proposed several Principles that would apply only to those BMs that are based on submissions,[20] it has not further defined the term "submission-based". We believe that this might create some challenges. For example, it seems unclear how one would treat BMs that use submissions only as *one* of their inputs, in addition to other input data such as transactions and bid/offer quotes. We therefore encourage IOSCO to further clarify the meaning of "submission-based".

c) Implementation

IOSCO proposed that national regulators would make policy decisions about the regulation of financial BMs in their respective jurisdictions based on the IOSCO Principles.[21]

Given the international nature of the creation and use of BMs and indices we believe that such approach to the implementation of IOSCO's Principles for Financial BMs would be problematic. We generally believe that it will not be effective for BM classifications to be made on a national level as it could not only open up opportunities for regulatory arbitrage but it is also unclear how regulatory requirements would actually be implemented. For example, IOSCO should consider how requirements would be implemented for BMs that are regarded as significant BMs in one jurisdiction given their widespread use by local entities, but are produced by BM Administrators that are based in other jurisdictions.

Responses to IOSCO's specific questions

Question 1. Equity indices

Indices may be used to measure a wide range of underlying Interests, using a variety of calculation methodologies and inputs. In the specific case of equity indices, inputs are typically based on transactions concluded on Regulated Markets. In light of this: are there any principles or parts of the principles that cannot, or should not, be applied to equity indices? If so, please identify these principles and explain why their application is inappropriate.

In its proposed Principles for Financial Benchmarks IOSCO explicitly differentiates between BMs that are submission-based, to which additional requirements would apply, and those that are not. It is therefore already the case that many requirements that are part of the Principles would not apply to BMs that rely on data inputs from exchanges, such as most equity indices.

However, we believe that some general principles, such as ensuring the quality and the accuracy of data inputs into a BM determination, the design of appropriate controls around the BM calculation, the appropriateness of rules of index creation and the use of expert judgment in determining their composition

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where the misconduct is related to financial firms, products, and the provision of financial services or the trading of securities and derivatives, although Benchmark setting is not of itself a regulated activity." IOSCO Consultation Report: Discussion of options for enhanced oversight of Benchmark activities.

[19] The term "index" refers 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 widely referenced BM, that calculation process may also be the subject of BM regulation.

[20] IOSCO CR Principle 13: Submitter Code of Conduct. Additionally, IOSCO highlights specific requirements for submission-based benchmarks in Principle 4: Control framework for administrators, Principle 10: Content of the Methodology, and Principle 17: Audit Trail.

[21] "IOSCO members should encourage implementation of the principles..." IOSCO CR: Chapter 1, Implementation.

are of crucial importance for *all* BMs and indices, not just for those in the non-equity asset classes. We therefore believe that some general principles for the regulation of BMs should apply equally across all asset classes. While any regulatory regime for BMs should certainly be designed to differentiate between various types of BMs, such differentiation should be based on the *characteristics* of the individual BM, not just on the asset class they reference. For example, from the regulatory perspective, there should be little difference between indices for illiquid equities and fixed income indices. Also, if IOSCO determined that there was a need for submission-based BMs to be subject to further requirements,[22] any submission-based indices should be exposed to those same requirements, regardless of the asset class.

Question 2. Additional measures to address risks resulting from Submission-based BMs or ownership or control structures
Additional measures have been specified within certain principles to address specific risks arising from a reliance on Submissions (principles 4, 10, 13 and 17) and/or from ownership or control structures (Principles 2, 5 and 16).
a. Should these additional requirements apply to Submitters and Administrators of all submission-based BMs or BMs with the specified ownership/control structures?
b. If not, please explain why all or some submission-based BMs or BMs with the specified ownership/control structures should be exempt.

We note IOSCO's intention to distinguish between types of BMs depending on whether they are based on submissions or on other inputs and we appreciate that this would be used as one of the means to calibrate the regime. However, while many proposed Principles for submission-based BMs seem sensible, we believe that requiring the BM Administrator to impose a demanding Code of Conduct on the Submitters to its BMs might cause some unintended consequences and should therefore be reconsidered by IOSCO.

IOSCO should note that, if a demanding Submitter Code of Conduct has to be implemented by BM Administrators ("***BMAs***") as proposed, it might unintentionally harm the quality (and in the extreme even the availability) of submission-based transparency creating BM services across various asset classes and products. This is because Submitters to BMs today, even if BM Administrators will provide them with some incentives, will generally provide their contributions on a voluntary basis. We therefore see a risk that many BM Submitters would rather discontinue their contributions to a BM than exposing themselves to stringent requirements. This issue could be particularly acute in asset classes that are less liquid and BMs that rely on Submitters that are unregulated entities. In the extreme it could lead to reduced transparency and even availability of hedging instruments.[23]

We therefore recommend for IOSCO and national regulators to set the scope of any regulatory requirements for submission-based BM services to focus on Libor-type BMs, also because they might often have means to ensure that Submitters continue their participation in these BMs. This objective of setting an appropriate scope can be achieved by strictly applying the factors as explained in more detail above.

Question 3. Notice Concerning Use of Expert Judgment
Should Administrators be required to briefly describe and publish with each BM assessment:
a. a concise explanation, sufficient to facilitate a User's or Market Authority's ability to understand how the assessment was developed, terms referring to the pricing methodology should be included (e.g., spread-based, interpolated/extrapolated or estimate-based); and
b. a concise explanation of the extent to which and the basis upon which judgment (i.e. exclusions of data which otherwise conformed to the requirements of the relevant methodology for that assessment, basing assessments on spreads, interpolation/extrapolation or estimates, or weighting bids or offers higher than concluded transactions etc.), if any, was used in establishing an assessment.

[22] For example, Principle 13: Code of Conduct. IOSCO CR: Financial Benchmarks.
[23] This might be the case in less liquid asset classes such as commodities where submission-based benchmark levels are used as underlying for tradable products.

We appreciate that IOSCO would allow BM Administrators to use their expert judgment as an input into the determination of a BM, where appropriate. We agree that the provision of general information regarding the pricing methodology applied and the use of expert judgment is useful to facilitate BM users' ability to understand the basis of the BM determination. We therefore generally support the idea that the BM Administrator should provide stakeholders with some details of calculation methodologies used for the BM assessment, a hierarchy of data inputs, and a general explanation of how expert judgment fed into the BM determination. We also support IOSCO's view that such descriptions should be updated periodically.

However, we are concerned that some elements of this requirement might turn out to be overly demanding. Firstly, IOSCO stated that the provision of such information would be expected "with each BM assessment". If this meant on the level of the individual submission to a BM or with each BM calculation by the BM Calculation Agent we believe it would be overly burdensome while adding little value. Further, IOSCO proposed to require the BMA to disclose the "extent to which" the BM determination relies on the use of expert judgment. However, in our experience it is impossible to quantify the exact degree of expert judgment that was used for each BM determination, for example as a percentage.

We therefore encourage IOSCO to clarify whether the requirement for the BMA to determine and disclose how expert judgment fed into the BM determination could be satisfied by the provision of a general, qualitative statement that is updated from time to time.

Question 4. Revisions to the principles

Please provide any suggested changes to specific principles or definitions of key terms set out in Annex A, including drafting proposals and rationale. Are any other principles needed: Should principles to address any additional issues, risks or conflicts of interest be developed? Please provide a summary of the issue and drafting for the proposed principle.

Principle 1. Overall responsibility of the Administrator

IOSCO defines the roles and activities of the BM Administrator, the BM Calculation Agent, and the BM Publisher.[24] Further, the proposed definition of BMA as well as Principle 1[25] explicitly state that the BMA would be regarded as the entity that is ultimately responsible for the BM regardless of whether it owns the intellectual property of the BM or not.[26] At the same time, the CR does not contain any reference to the BM Sponsor, to its role or to its responsibilities.

From our experience as an index provider, the BM Sponsor is the entity that designs the BM or index, sets the index rules and owns the intellectual property of the BM. While in practice some BM Sponsors decide to outsource many BM-related functions such as the administration and the calculation of their BMs, they remain responsible for the BM development, which includes tasks such as rule updates or changes, and the cessation of the BM. We therefore believe that it is the BM Sponsor, not the BMA, that should be ultimately responsible for the accuracy and reliability of the BM. Given the variety of operational models and varying extent of delegation, IOSCO should take a functional approach to the regulation BM activities with the ultimate responsible assigned to the BM Sponsor.

Principle 7. Data sufficiency and Principle 8. Hierarchy of data inputs

IOSCO proposed that the data that is used as input into the calculation of a BM "should be based on prices, rates, indices or values that have been formed by the competitive forces of supply and demand and be

[24] IOSCO CR Annex A: Glossary of Key Terms.
[25] Overall Responsibility of the Administrator
[26] "Administrator: An organisation or legal person that controls the creation and operation of the Benchmark Administration process, whether or not it owns the intellectual property relating to the Benchmark. In particular, it has responsibility for all stages of the Benchmark Administration process, including: a) The calculation of the Benchmark; b) Determining and applying the Benchmark Methodology; and c) Disseminating the Benchmark." IOSCO CR Annex A: Glossary of Key Terms.

anchored by observable transactions entered into at arm's length between buyers and sellers in the market for the Interest the Benchmark measures."[27]

Experience has shown that reliable BM levels can be more easily determined in asset classes where the relevant underlying instruments trade continuously, while it requires more effort in asset classes where trading occurs only on a sporadic basis. We therefore agree with IOSCO that different asset classes require different approaches in the construction (and regulation) of BMs and indices. We also welcome IOSCO's statement that a preference for transaction data does not imply that the use of non-transactional information is inappropriate.[28] We are further generally supportive of the use of data input hierarchies that take into account a wide range of data sources, including various sets of non-transactional data, while allowing the use of expert judgment, where appropriate. We believe that such approach, as long as it is carefully designed, would allow for the Principles for the regulation of BMs to be applicable to a broad range of BMs and indices across asset classes.

However, we are concerned about IOSCO's statement that non-transactional data may be used only as an "adjunct or supplement to transaction data" for the determination of BMs[29] given that transparency-creating BMs in most asset classes simply cannot be based solely on transactions. This is not only because transactions in many asset classes or product categories are often not publicly available but also because transactions mostly occur only on an infrequent basis and for a portion of the universe of the relevant instruments. As a consequence, the use of other information sources and expert judgment are essential to construct and calculate these BMs in a reliable and accurate manner. We also note that a requirement to use non-transactional data only as an "adjunct" does not seem consistent with the regime for the regulation of BMs that has been established in the UK.[30] The UK regime also allows for the use of carefully designed hierarchies of a wide range of data sources, which could include non-transactional data, and highlights the "crucial" importance of the use of expert judgment.[31]

In sum, we believe that a requirement for all BMs to be anchored in transactions[32] is misguided and, if taken literally, could cause severe unintended consequences that would be to the detriment of market participants in many market segments. While it seems as if it was IOSCO's intention to provide some flexibility regarding the use of a variety of inputs beyond transaction levels,[33] we believe that its statements require further clarification.

Principle 12. Transition

IOSCO proposed that BMAs should have "clear written policies and procedures, to address the need for possible cessation of a Benchmark, due to market structure change, product definition change, or any other condition that makes the Benchmark no longer representative of its intended Interest."[34]

We question whether there is a need to impose such requirements in relation to transition on all BM providers.[35] We appreciate that IOSCO proposes that the BMA must establish clear written policies and procedures that are proportionate to the breadth and depth of contracts and financial instruments that

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[27] IOSCO CR Principle 7: Data Sufficiency.
[28] "The principle does not prohibit the use of non-transactional data such as bids and offers, or adjustments based on Expert Judgement…" IOSCO CR Principle 7: Data Sufficiency.
[29] IOSCO CR Principle 7: Data Sufficiency.
[30] "[A]n effective methodology for determining benchmark submissions includes the use of qualitative criteria, such as the expert judgement of the benchmark submittor." FSA PS 13/6: The regulation and supervision of benchmarks, page 20 (March 2013).
[31] "We agree that including expert judgment within submission methodologies is crucial. This is particularly the case where there are low number of transaction volumes in the market underlying the benchmark." FSA PS 13/6: The regulation and supervision of benchmarks, page 20 (March 2013).
[32] IOSCO CR Principle 7: Data Sufficiency.
[33] IOSCO CR Principle 12: Transition.
[34] IOSCO CR Principle 12: Transition.
[35] "The Consultation Report also considered issues that Market Participants might confront when seeking to make the transition to a new or different Benchmark. For example, where there is insufficient data to support a Benchmark, Market Participants should consider the possibility of transitioning away from such a Benchmark." IOSCO CR, page 2.

reference a BM and the economic and financial stability impact that might result from its cessation. However, IOSCO should be aware that the issue of transition is much less relevant for some products that might be in scope of the BM definition. For example, many indices are solely used for performance attribution and are not referenced in financial instruments. Further, a number of competing index products typically exists. Users of these products, for example fund managers, are hence not bound to using these indices for the lifetime of any underlying products and they might just switch to competing products as long as the new index is substantially similar and any necessary changes are made to the fund's prospectus.

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Markit appreciates the opportunity to comment on IOSCO's Consultation Report on *Principles for Financial 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 Schüler at marcus.schueler@markit.com.

Yours sincerely,

Kevin Gould
President
Markit