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Consultation Paper – Handbook changes to reflect the application of the EU Benchmarks Regulation

Dear Sirs,

IHS Markit is pleased to submit the following comments to the Financial Conduct Authority (FCA) in response to its Consultation Paper (CP) on Handbook changes to reflect the application of the EU Benchmarks Regulation.

IHS Markit[1] (Nasdaq: INFO) is a world leader in critical information, analytics and solutions for the major industries and markets that drive economies worldwide. The company delivers next-generation information, analytics and solutions to customers in business, finance and government, improving their operational efficiency and providing deep insights that lead to well-informed, confident decisions. IHS Markit has more than 50,000 key business and government customers, including 80 percent of the Fortune Global 500 and the world's leading financial institutions. Headquartered in London, IHS Markit is committed to sustainable, profitable growth.

IHS Markit is a leading independent provider of fixed income and economic indices, calculating more than 17,000 indices globally. Our indices include the iBoxx bond indices, the iTraxx®, CDX® credit derivative indices and Halifax House Price Index. We also produce Coal and Oil Price indices. Leveraging our experience in designing, administering and calculating indices, we also provide index related services to enable customers to meet custom or bespoke index requirements.

[1] See www.ihsmarkit.com for more details

Comments

Indices and benchmarks play an important role in enhancing transparency, liquidity and access in financial markets around the globe, they contribute to broadening the base of investable assets in the EU and are crucial elements driving economic development. We welcome the EU Benchmark Regulation (***BMR***) as an important framework to protect investors and ensure confidence in benchmarks.

We provide detailed answers to specific questions below, but would comment that while we generally support the proposal from the FCA to implement the BMR for financial benchmarks, we would like to make the following points:

i) BMR implementation must ensure that EU users can continue to use benchmarks from administrators in third countries. The FCA should implement a workable regime so UK benchmark administrators can endorse third country benchmark families in a proportionate, efficient manner. This is likely to mean an active EU Benchmark Administrator having involvement in the oversight function with rights to delve deeper if they had concerns about whether provision was as stringent as the BMR;
ii) the BMR achieved a balance between necessary requirements and disproportionate burden. The FCA should avoid super-equivalent implementation; and
iii) the FCA should fully reflect the BMR regime for commodity benchmarks in its implementation to ensure clarity for administrators and users of benchmarks.

Questions

Q1: Do you agree with our proposals to adapt the Handbook to be consistent with the BMR?

IHS Markit appreciates and generally supports the FCA's proposals for changes to the handbook to implement the BMR for financial benchmarks. We also welcome the fact that potential administrators will be able to discuss their applications with the FCA from October 2017, something that should be very useful in mitigating the risks around market disruption caused by the implementation of the BMR. We do have comments around: i) third country benchmarks; ii) additional requirements and iii) commodity benchmarks.

i) Third Country Benchmarks

Benchmarks are a global business and offer investors important options to gain exposure to non-EU markets. Following the recent clarification by ESMA of the transitional periods between 2018-2020,[2] we believe that special attention should be paid by the FCA to ensuring EU-based users of benchmarks continue to be able to use new and existing benchmarks provided from outside the EU in a timely way,

[2] www.esma.europa.eu/sites/default/files/library/esma70-145-114_qa_on_bmr.pdf

without disproportionate costs and with equal confidence that they are equally robust and not subject to the risks from conflicts of interest the BMR aims to mitigate.

For any benchmark used in the EU, the administrator should be able to demonstrate control over its provision and that this meets the requirements of the BMR.[3] Regardless of whether benchmarks used in the EU are provided under the control of an EU administrator, or through the recognition or endorsement regimes, users and regulators must have confidence that equivalent standards are being adhered to through rigorous oversight and controls. It is our view that, in the absence of equivalence,[4] some form of oversight by an EU administrator is always required. Therefore, we would urge the FCA to implement the BMR in a manner that ensures: UK administrators can take responsibility for provision of all in-scope benchmarks that it has oversight and ultimate control over; and provides a route for UK administrators to endorse third country benchmarks efficiently and effectively.

We are concerned that inconsistencies in the requirements EU administrators face under BMR and those expected of third country administrators using the endorsement or recognition regimes could have negative impacts and potentially result in regulatory arbitrage. If standards are less rigorous outside the EU then administrators could take advantage of lower compliance requirements or accountability. Equally, an overly strict regime with unworkable requirements expected of third country benchmarks could either deny the EU use of third country benchmarks or force administrators to produce duplicate EU versions of successful benchmarks, which would then have differing standards to the global versions. This could fragment the benchmarks market, create different levels of robustness that users would find hard to understand, distort transparency in how a benchmark is used and create confusion about where oversight lies. The balance between IOSCO and BMR needs to be carefully considered.

We have concerns about the recognition regime and do not believe it provides an effective, long-term mechanism for allowing third country benchmarks to be made available to EU users. It seems highly unlikely any EU entity that was not an active benchmark administrator would have the expertise to ensure a benchmark was being administered in the third country to a sufficient standard. This could mean the FCA would need to become actively involved in the supervision of the third country firm, which would be resource intensive and could be politically sensitive.

Instead we would agree with ESMA's view that "the endorsement mechanism should be viewed as a mechanism to allow the use of third country benchmarks not yet used in the EU territory or to allow the use of benchmarks already referenced in the EU also in new financial contracts/instrument and/or investment funds".[5] Therefore it will be important for the FCA to provide a clear and proportionate route for UK administrators to endorse non-EU benchmarks.

We believe that the FCA should support and clarify the process for UK benchmark administrators to provide an endorsement service to third country benchmark

[3] BMR Article 3(1)(6)
[4] BMR Article 30
[5] ESMAs *Final Report on Technical Advice on Benchmarks Regulation* para 162

administrators. To provide such a service, Article 33(1) of the BMR states that endorsing EU administrators need all of the following:

i) "the necessary expertise to monitor effectively the activity of the provision of a benchmark in a third country and to manage the associated risks";

ii) "an objective reason to provide the benchmark or family of benchmarks in a third country and [for them] to be endorsed for their use in the Union";

iii) "a clear, well-defined role within the control or accountability framework of the third country administrator" and, through this role, the EU administrator must be able to "monitor effectively the provision of a benchmark"; and

iv) to have verified and be "able to demonstrate on an on-going basis to its competent authority that the provision of the benchmark or family of benchmarks to be endorsed fulfils … requirements which are at least as stringent as the requirements of this Regulation", although competent authorities may take into account that compliance with the relevant IOSCO principles would be equivalent to compliance with the requirements of BMR.

We believe that authorisation and ongoing activity as an EU benchmark administrator would be a clear indication that an organisation had the necessary expertise, as specified in i) above. Consideration of: the benefits of the existing or potential use in the EU of a non-EU benchmark; if the economic reality the benchmark seeks to measure is not related to the EU; or the administer has a significant number of non-EU based clients, workforce or contributors, should provide objective reasons for the benchmark to be provided outside the EU, as required in ii) above.[6]

We would expect that the requirement set out in point iii) for a well-defined role in the control or accountability equates naturally to taking a role on the oversight function or committee of the third country administrator to be endorsed. Such a role would enable the endorser to ensure adequate oversight arrangements exist and provide surveillance of the control framework, as required by BMR Article 5. Under this arrangement the endorser would have a view on all aspects of compliance with the regulation and could raise any concerns they had about IOSCO compliance or whether a benchmark was being produced in a way at least as stringent as the requirements of the BMR.

The BMR is clear that the purpose of the governance arrangements is to provide oversight to control conflicts of interest and to safeguard the integrity of the benchmark, which is the very essence of the BMR.[7] As stated above, an active, authorised EU benchmark administrator would be able to consider whether the third country administrator was achieving this and meeting their understanding of the BMR. The ultimate sanction available to the endorser would be to withdraw endorsement if they felt serious concerns were not being addressed. Deeper involvement would be disproportionate and unnecessary in most cases. However, endorsing EU

[6] See also ESMAs *Final Report on Technical Advice on Benchmarks Regulation* section 5
[7] BMR Recital 21

administrators should ensure they had sufficient rights and access to the third country administrators to effect deeper involvement that could be deployed if necessary.

Finally we would urge any implementation of the third country regime to focus on benchmark families, rather than individual benchmarks, to reduce the burden on both administrators and the regulator. We look forward to further discussion with the FCA.

ii) Additional Requirements

It is notable that the FCA seems to have added some additional requirements and not fully reflected the exemptions of the BMR in its proposed implementation. The EU co-legislators examined the balance between the requirements and their potential impact on the benchmark industry. The final legislation reflected a well thought through, balanced and calibrated set of requirements. This should help mitigate risks around conflicts of interest and ensure the accuracy and integrity of benchmarks without adding disproportionate burdens on administrators, contributors and users. Disproportionate requirements could lead to a chilling of the industry and poorer quality benchmarks – something that would be in nobody's interest and work contrary to the objectives of the BMR.

Therefore we would not support the FCA's suggested approach requiring supervised benchmark contributors to notify the FCA directly of any suspicion of manipulation or attempted manipulation.[8] The accuracy of any index relies on getting as broad as possible input from relevant contributors. Placing additional requirements on contributors is likely to lead to contributors being less willing to participate, leading to less accurate indices. Although it sounds reasonable to inform the FCA of suspected manipulation, it is a very imprecise requirement that will be hard for contributors to judge and therefore hard for them to be sure of compliance. This would add to the burden of contributing. The administrator is likely to be in a far better position to judge potential manipulation and there will be a requirement on them to inform the FCA. Therefore we believe this proposal will add little value and potentially lead to withdrawal among the contributor populations.

We also note that the important exemptions set out in the BMR Article 2(2) are not reflected in the FCA proposal. Of course these exemptions are clear in the BMR, but we believe that for the sake of clarity for users, the changes to the handbook should be explicitly state that users may continue to use indices benefiting from these exemptions.[9]

[8] CP 4.17

[9] The exemption states that BMR does not apply to: central banks; public authorities providing or contributing to benchmarks for public policy purposes; central counterparties providing reference settlement prices used for CCP risk-management purposes and settlements; the provision of a single reference price for any financial instrument; the press, media and journalists; a person publishing its own variable or fixed borrowing rates; commodity benchmarks referenced only by financial instruments trading on one trading venue and with a total notional value less than EUR100 million; and if the provider is unaware its index is being used as a benchmark.

iii) Commodity Benchmarks

Although the CP generally well reflects the financial benchmarks requirements of the BMR, we are unable to find the equivalent provisions applying BMR Annex II provisions for commodity benchmarks and disapplying the irrelevant provisions. While the BMR is clear that these provisions need not apply, we believe that it would a useful point of clarity for users and administrators if the FCA handbook was also clear about this. Similarly users will benefit from comfort that they are able to use commodity benchmarks that qualify for the exemption.

Furthermore, as set out above, the additional requirements the FCA is proposing to place on contributors would be particularly problematic. Participation by data submitters in the price discovery process is completely voluntary and relies upon the active consent of risk control departments within the submitting companies. Already with the advent of IOSCO Principles, some firms have opted to quit reporting market activity at all for fear of possibly omitting something and thereby opening themselves up to liability.

Additionally, while administrators will, of course, cooperate with regulatory agencies to the full extent required by law, price reporting agencies are not in a position to accuse data submitters of breaking the law without exposing ourselves to libel charges. Instead, our market assessors and senior management actively vet data submissions by survey of other market participants; cross-verifying pricing information as it comes in before publishing our daily price assessments. A list of approved sources is kept, reviewed and maintained by staff and management and use of any data submitted by a source not on the approved sources list is strictly prohibited.

We would, therefore, urge the FCA to fully and explicitly represent the BMR provisions for Commodity benchmarks, including the exemption for small commodity in the handbook, and avoid additional requirements.

Q6: Do you agree with the cost benefit analysis for our policy proposals set out in Annex 2?

Please see our answer to Question 1 on the requirement for supervised contributors to notify the FCA about suspicions of manipulation of a benchmark.

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We hope that our above comments are helpful. We would be more than happy to elaborate or further discuss any of the points addressed above in more detail. If you have any questions, please do not hesitate to contact us.

Yours sincerely,

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