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## CFR Consultation Paper on Financial Benchmarks Regulatory Reform

Dear Sirs,

Markit is pleased to submit the following comments to the Council of Financial Regulators (the “**CFR**”) in response to its Consultation Paper on Financial *Benchmarks Regulatory Reform* (the “**Consultation Paper**” or the “**CP**”).

Markit<sup>1</sup> is a leading global diversified provider of financial information services.<sup>2</sup> Founded in 2003, we employ over 4,000 people in 11 countries and our shares are listed on Nasdaq (ticker: MRKT). Markit has been actively and constructively engaged in the debate about regulatory reform in financial markets, including topics such as the implementation of the G20 commitments for OTC derivatives and the design of a regulatory regime for benchmarks. Over the past years, we have submitted more than 150 comment letters to regulatory authorities around the world and have participated in numerous roundtables.

### Introduction

Markit is a significant index administrator<sup>3</sup> and provider of index-related services, with leading proprietary indices in the global fixed income markets and a growing activity in independent index administration:

- We develop and administer a range of proprietary indices covering loans, bonds, credit default swaps, structured finance and economic indicators. Our suite of proprietary benchmarks includes the widely used Markit iBoxx bond indices and the Markit CDX and iTraxx CDS Indices.
- Markit is an independent benchmark administrator for a number of customer-owned benchmarks. In this role, we control the benchmark methodology and oversee all submission, determination and distribution processes.

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<sup>1</sup> See [www.markit.com](http://www.markit.com) for more details.

<sup>2</sup> We provide products and services that enhance transparency, reduce risk and improve operational efficiency of financial market activities. Our customers include banks, hedge funds, asset managers, central banks, regulators, auditors, fund administrators and insurance companies. By setting common standards and facilitating market participants' compliance with various regulatory requirements, many of our services help level the playing field between small and large firms and foster a competitive marketplace.

<sup>3</sup> See <http://www.markit.com/product/indices> for more details

Markit administers both its own Benchmarks and those owned by its customers in accordance with the IOSCO Principles for Financial Benchmarks<sup>4</sup> (the “*IOSCO Principles*”). Our compliance framework includes the following key components:

- Administrator Code of Conduct detailing the policies and procedures to be followed by Markit as benchmark administrator;
- Governance and oversight structure designed to reconcile regulatory compliance with daily business management and industry expertise;
- Conflicts of Interest and Complaints policies and procedures;
- Publication of transparent benchmark methodologies; and
- Submitter Code of Conduct which details controls Markit expects Submitters to adopt in accordance with IOSCO Principle 14.<sup>5</sup>

Furthermore, Markit maintains internal management committees that are accountable for the overall operation of our benchmarks and indices. Index Management Boards are convened for Markit’s proprietary benchmarks (each family of indices typically has its own management board) whilst an Index Administration Committee is convened for customer owned benchmarks. Additionally, in order to enhance independence and objectivity of the benchmarks we administer, Markit can seek advice from market participants on specific benchmark related issues. The objective of these consultations is to solicit feedback which can assist the Administrator in the creation of the highest quality standards for its indices.

## Comments

We welcome the publication of the Consultation Paper by the CFR and we appreciate the opportunity to provide you with our comments.

We particularly appreciate the CFR’s recognition of benchmarks being “of critical importance to a wide range of financial markets and throughout the broader economy”<sup>6</sup> and its initiative to establish a regulatory framework in Australia to protect “investor trust and confidence in the integrity of key financial benchmarks”.<sup>7</sup> Our experience has shown that indices and benchmarks do indeed play an important role in enhancing transparency, liquidity and access in financial markets around the globe and can also contribute to broadening the base of investable assets in Australia. On that basis we recommend the CFR ensure that its final rules for the regulation of significant benchmarks in Australia are sufficiently proportionate as well as workable so they do not chill innovation in this important sector.

Based on our broad-based experience in the index business we believe we are well positioned to provide the CFR with some valuable recommendations. Specifically, we recommend that the CFR:

- Recognize the use of independent index administrators as an effective mechanism to mitigate conflicts of interest inherent in benchmark administration and use;
- Further restore confidence in indices and benchmarks by expecting more broadly compliance with the IOSCO Principles for AUD denominated benchmarks;
- Apply clear and consistent criteria for determining which benchmarks are in scope of the regulation to reduce uncertainty and secure continued innovation in benchmarks;
- Avoid specifying a notional amount outstanding as input into the determination of whether a benchmark is in scope; and

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<sup>4</sup> [http://www.markit.com/Content/Documents/Products/Disclosures/MKT\\_IOSCO\\_Statement.pdf](http://www.markit.com/Content/Documents/Products/Disclosures/MKT_IOSCO_Statement.pdf)

<sup>5</sup> Documentation in relation to Markit’s compliance with the IOSCO Principles can be found here: [www.markit.com/Documentation/Product/Indices](http://www.markit.com/Documentation/Product/Indices)

<sup>6</sup> Pg. 1, Introduction

<sup>7</sup> Pg. 2, Problem identification and regulatory objective

- Allow for a flexible approach towards implementation of the Submitter Code of Conduct while recognizing that benchmark administrators are not in a position to “regulate” their submitters.

When finalizing its rules, the CFR should also take into account certain trends that currently play out in benchmark administration in other jurisdictions driven by the increased attention to managing and mitigating conflicts of interest. Specifically, Benchmark administrators that issue products that reference these benchmarks or firms that are users of the benchmarks they administer (e.g., asset managers producing indices for the measurement of the performance of their funds) are increasingly transferring benchmark administration to independent third parties to mitigate the regulatory and reputational risks arising from conflicts of interest. As such the CFR should reflect the role of independent index administration and recognize this approach as an effective mechanism to reduce the risk of benchmark manipulation and misconduct.

## **Responses to the CFR’s questions**

### **Q1: Do you have any comment on the proposed definition and scope of significant financial benchmarks?**

We support the CFR’s proportionate approach to the regulation of benchmarks by applying the regulation directly only to the most significant AUD denominated benchmarks, while at the same time ensuring that “any new offence of benchmark manipulation [...] extend to all financial benchmarks so as to promote market integrity across all benchmarks”. We agree with the CFR’s reasoning that “imposing the administration and submission regulatory requirements on all financial benchmarks would be a resource-intensive and costly exercise both for regulators and the regulated community”<sup>8</sup> and should hence be avoided.

However, the CFR should note that, over the last several years, Benchmark Administrators around the globe have already moved to administer their Benchmarks in accordance with the IOSCO Principles. There might therefore be little additional effort required if the CFR expected Administrators of the broader range of AUD denominated Benchmarks to comply with the IOSCO Principles while it could be an effective way of further boosting confidence in the broader indices and benchmarks sector.

### **Q4: Do you have any comment on the proposed mechanism for designating the scope of regulation?**

We believe that predictability and clarity around which Benchmarks would be included in scope of the regulation in Australia will be very important to ensure market functioning and continued innovation in this sector. The CFR should hence apply clear and consistent criteria for the determination of benchmarks for inclusion in the scope of the Regulation.

In this context, the CFR should note that regulatory regimes in other jurisdictions make reference to notional amounts outstanding in financial contracts and instruments that reference the benchmark to assess whether such benchmark is systemically important and should be subject to a stricter regulation.<sup>9</sup> However, such regime will be difficult to implement since under typical licensing agreements for indices and benchmarks, users of benchmarks do not provide benchmark administrators with information about the value of the instruments or contracts using their benchmarks and they are unlikely to do so in the future. On the other hand, there are no reliable public sources of information that would allow for these amounts to be determined across all use cases. Benchmark administrators and users would therefore be left with a high degree of uncertainty as to whether a benchmark would be in scope of the regulation (and, where applicable, to which category of benchmark it would be assigned) if the criteria included pre-defined notional amounts. This uncertainty would likely stifle innovation in the index sector.

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<sup>8</sup> Pg. 3, Scope of coverage

<sup>9</sup> For example, the EU Benchmark Regulation specifies notional amounts outstanding in financial contracts and instruments, which refer to a particular benchmark either to determine the payout of the contract/instrument or to measure the performance of the investment fund, as one of the criteria in determining the systemic significance and hence the rules applicable to those benchmarks.

We therefore recommend the CFR avoid proposing a methodology for assessment of significance of the Benchmark that contains any reference to specific notional amounts. If the CFR chose to make use of notional amounts in its assessment it might consider compelling regulated users of benchmarks to provide the information on notionals of use. Notional amounts could be reported either to the administrator of the benchmark or to the relevant regulatory authority and would result in increased certainty about the designation of the benchmark.

**Q7: Among the options presented, which option do you prefer for regulating benchmark submission, and why?**

We believe the most practical approach for regulating benchmark submission would be via a Submitter Code of Conduct (“**SCoC**”). However, the CFR would need to consider the challenges and limitations of this approach as outlined below.

**Q8: Do you consider that benchmark administrators would be able to effectively regulate submitters via a Submitter Code of Conduct?**

Our experience in implementing the IOSCO Principles for the administration of Benchmarks has shown that establishing a SCoC with Submitters to a benchmark is subject to certain challenges and limitations. Such challenges are most pronounced in relation to benchmarks that cover less liquid and less transparent markets and/or only have a small number of contributors.

We therefore recommend the CFR provides Benchmark Administrators with sufficient flexibility to determine how to best implement the SCoC. We believe it should be acceptable and pragmatic to require the Benchmark Administrator to issue a SCoC, call for Submitters to comply, and only use submissions from Submitters that it believes are in compliance with the SCoC. However, the CFR should recognize that Administrators will not be in a position to “regulate” contributors via a SCoC or to actively enforce compliance.

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We hope that our above comments are helpful to the CFR. 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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