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ESMA Consultation Paper on Draft technical advice under the Benchmarks Regulation

Dear Sirs,

Markit is pleased to submit the following comments to ESMA in response to its Consultation Paper on *Benchmarks Regulation* (the "***CP***").

Markit[1] is a leading global diversified provider of financial information services.[2] 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 140 comment letters to regulatory authorities around the world and have participated in numerous roundtables.

Introduction

Indices and benchmarks play an important role in enhancing transparency and liquidity in financial markets around the globe, they allow for easy access to asset classes and thus contribute also to broadening the base of investable assets in the EU, a crucial element for the success of the CMU project. As outlined in our response to the previous ESMA Discussion Paper on the EU Benchmark Regulation ("***the Regulation***"),[3] we welcome the Regulation as an important framework to protect investors and restore confidence in benchmarks. In the context of this CP we recommend ESMA focuses on the workability and proportionality of their advice so it does not result in chilling innovation in this important sector.

Specifically, our main recommendations are:

- When specifying what constitutes "administering the arrangements for determining a benchmark", care should be taken to allow Benchmark owners to dispose of Benchmarks or use an independent administrator to mitigate risks around conflicts of interest. ESMA's proposed wording could be read as meaning that the administrator must have had a role in developing the original methodology. This would not only be overly prescriptive but also unworkable. We would suggest ESMA's advice is made clear that

[1] See www.markit.com for more details.
[2] 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.
[3] www.markit.com/Company/RegulatoryResponsesFile?CMSID=a626622b982e4e9db30fbf49306d8fab

administering the benchmark is about ensuring the ongoing methodology remains appropriate for the Benchmark.

- The requirements around measuring the size of a Benchmark need to be workable. ESMA sensibly suggests using data reported under other legislation. However such data would not be available to the benchmark administrator as reporting is usually confidential and only accessible by trade repositories or competent authorities. The roles of administrators and competent authorities should be established and, given the difficulties over establishing accurate figures, the advice should specify that classification should be performed on a "best effort basis".

Responses to ESMA's questions

Q1: Do you agree with the conditions on the basis of which an index may be considered as made available to the public?

We support ESMA's proposal as in line with the Regulation's intention to have a scope as broad as necessary to create a preventative regulatory framework.[4]

Q2: Do you agree with the proposed specification of what constitutes administering the arrangements for determining a benchmark?

Markit supports for the Benchmark Regulation to be as closely aligned with the IOSCO Principles as possible, as set out in the CP (para 36). However we would be concerned about the particular language of 'setting of a specific methodology' as part of the definition of administering the arrangements for determining a benchmark.

We believe that, as drafted, the wording on setting the methodology would be unworkable. It could be interpreted as meaning the administrator must have been involved in the original setting of the methodology (especially as it is differentiated from the very necessary periodic reviews). Such an interpretation would not allow firms to dispose of any benchmarks they have created as whoever acquired the benchmark would not have been involved in the original setting of the methodology. We are not aware of any other situation where there is an equivalent restriction on disposing of intangible assets. It would also cause confusion when firms attempt to mitigate their conflicts of interest by engaging an independent benchmark administrator. Independent benchmark administrators can help parties that develop indices to mitigate potential conflicts of interest and allow them to benefit from the expertise that such specialist services can bring. However they are unlikely to be involved in the original setting of the methodology when the benchmark was being established as their role would be called for as a Benchmark's use grows and the need for robust management of conflicts of interest becomes more important. This is foreseen in the proportional approach of Level 1, with requirements becoming stricter as the use of a Benchmark grows from non-significant, to significant and critical.

We do not believe that ESMA's intention is to restrict disposals of Benchmarks or the use of independent administration. However, we would advocate for administering the arrangements to be about the ongoing reviews of the methodology to ensure that it remains fit for purpose as expressed in the Benchmark statement. ESMA seems to acknowledge the potential role of an independent benchmark administrator when it concludes that all aspects of the provision may be outsourced and acknowledges the possible development of different business models (para 37). We would therefore suggest that ESMA avoid confusion but maintains its objectives with a simple change to its advice:

"*the **ongoing** setting of a specific methodology for the determination of each benchmark or, with the necessary adaptations, each family of benchmarks provided, and its maintenance through periodic reviews*"

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[4] As spelt out in, for example, Recital 8 of the Regulation.

Q5: What are your views on the transitional regime proposed to assess the nominal amount of financial instruments other than derivatives, the notional amount of derivatives and the net asset value of investment funds in the case where the regulatory data is not available or sufficient?

Markit generally supports ESMA's proposal to base the calculation of Benchmark size on data reported under other legislation. However we are concerned that this data would often not be available to the benchmark administrator as it is usually reported on a confidential basis to trade repositories or national authorities. Further clarification would therefore be needed regarding how the information will be accessed and used by both administrators and competent authorities to calculate Benchmark size. Also, the draft advice does not clarify the respective roles of administrators and national authorities in this context. Finally, ESMA should clarify in its advice that, given the difficulties over establishing accurate figures, the classification should be performed on a "best effort basis" to avoid exposing the administrator to liability if the figures are later found, despite their best effort, to be inaccurate.

We note ESMA's comments in paragraph 75 about benchmarks used to measure performance not being excluded from calculation. However we would continue to remind ESMA and the European Commission that establishing accurate figures for such benchmark use is even more problematic and onerous than for other benchmark use. ESMA's comments would also likely lead to a less proportionate approach to managing the risks of benchmarks as it would potentially push more benchmarks into significant and critical categories based on their use in measuring performance even though they pose far less risk to the EU economy and consumers. This would clearly not be consistent with the objectives of the regulation to "provide for a proportionate response to the risks that different benchmarks pose".[5]

We continue to believe that the best solution would be to fully capture performance benchmarks in scope but not to include the usage of benchmarks as measures of performance in the calculation of critical or significant. However, if ESMA or the European Commission believe this would not be compatible with the Regulation, they should consider how to ensure that the measurement is made as practical possible by, for example, compelling users to report such usage to their administrator or competent authority. Benchmarks falling into the significant and critical categories but for which the majority of use is measurement of fund performance should be specifically identified to ensure proportionality can be applied in a way consistent with the Regulation's clear intent to focus on those benchmarks which cause the most potential risk.

Q6: Do you agree with the measurement performed at a specific point in time for assessing whether a benchmark hits the thresholds specified in Article 20(1) to be considered as critical?

We support ESMA's proposal for determination of non-critical benchmarks to take place over certain time periods, for example every 6 months. We believe the use of such time periods should allow changes in use to be reflected while reducing the costs of the measurement process compared to more frequent timings.

Q7: What are your views on the use of licensing agreements to identify financial instruments referencing benchmarks? Would this approach be useful in particular in the case of investment funds?

We agree with ESMA when it states that an alternative approach would be to use licensing agreements to identify licensed firms and have users of benchmarks provide the necessary information.[6] However, ESMA is also correct when it states that existing licensing arrangements do not usually cover the overall use of a benchmark. Where a licensing agreement covers a broad benchmark family without explicitly listing out every

[5] Recital 9 of the Regulation.

[6] Para 83

single benchmark in the family, it should be the responsibility of the licensed firms to report financial instruments and the specific referenced benchmarks licensed under this broad benchmark license.

ESMA is also correct when it states that some data provided to authorities might be confidential and therefore could not be given to administrators.[7] We believe EMSA should consider whether the final delegated acts should compel users to disclose information on their use of benchmarks to either benchmark administrators or national competent authorities and we agree this would be particularly useful in the case of investment funds use of "performance benchmarks". We believe it would be important to apply a uniform approach so that all licensing arrangements are treated the same (either all particular kinds of users are compelled to provide information or none are) to preserve a harmonised approach and to avoid regulatory incentives towards different kinds of licensing arrangements. Furthermore, ESMA should also be aware that on occasion users may create products without the appropriate licensing and these would not be included in any figures the administrator would have.

We would therefore recommend that ESMA ensure that its advice provides for a workable system where any licensing requirements are clear and uniform and the respective roles of administrators and national authorities in classifying Benchmarks are established without confusion.

As stated above, ESMA should clarify that, given the difficulties over establishing accurate figures, the classification should be performed on a "best effort basis" to avoid exposing the administrator to liability if the figures are later found, despite their best effort, to be inaccurate.

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We hope that our above comments are helpful to ESMA. 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 the undersigned or David Cook at david.cook@markit.com.

Yours sincerely,

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[7] Para 83