



4th floor  
Ropemaker Place  
25 Ropemaker Street  
London  
EC2Y 9LY  
United Kingdom

tel +44 20 7260 2000  
fax +44 20 7260 2001  
www.markit.com

Australia Securities & Investments Commission  
GPO Box 9827  
Sydney NSW 2001  
Australia

Submitted via email to [benchmarks-report@asic.gov.au](mailto:benchmarks-report@asic.gov.au)

London, September 11<sup>th</sup> 2015

## Consultation Report on *Financial Benchmarks*

Dear Sirs,

Markit is pleased to submit the following comments to ASIC in response to its Consultation Report on *Financial Benchmarks* (the "**Consultation Report**").

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 120 comment letters to regulatory authorities around the world and have participated in numerous roundtables.

### Introduction

Markit is a provider of 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, including the Markit iBoxx suite of bond indices and the Markit iTraxx and CDX CDS indices,<sup>3</sup> and we administer a range of third-party indices across asset classes.

Indices and benchmarks ("**BMs**") play a beneficial role in the financial markets by injecting transparency and liquidity, including for less developed market segments. Such benefits have been recognized not only by market participants but also by regulatory authorities that have worked with index providers to increase the transparency, liquidity, and tradability of their local financial markets by creating indices. However, the Libor-related events in 2011 brought the failings of some existing benchmark-related arrangements to the spotlight and caused market participants and regulators to re-examine their production.

Markit has been actively and constructively engaged in the discussion about establishing a regulatory framework for financial benchmarks in Europe,<sup>4</sup> the APAC region<sup>5</sup> and elsewhere. Based on our experience as

---

<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 Markit's services help level the playing field between small and large firms and herewith foster a competitive marketplace. For example, Markit's KYC Services provide a standardized end-to-end managed service that centralizes "Know Your Client" (KYC) data and process management.

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

<sup>4</sup> The European Commission issued a proposal for the regulation of financial benchmarks in Sep 2013. The European Parliament and the European Council subsequently issued their own versions of the proposals in December 2014 and February 2015 respectively. The three parties are in trilogue negotiations currently with a final agreement expected by the end of 2015.

an index administrator we have submitted responses to IOSCO,<sup>6</sup> to the European Commission,<sup>7</sup> to the FSA<sup>8</sup> and other regulatory authorities. Following the publication of the IOSCO Principles for Financial Benchmarks (the “*IOSCO Principles*”)<sup>9</sup> Markit announced in July 2014 that it would administer its benchmark products in compliance with these Principles.<sup>10</sup> After performing a thorough review of our various services we embarked on a project to ensure compliance and issued a statement of compliance with the IOSCO Principles in December 2014.<sup>11</sup>

## Comments

We commend ASIC for publishing its report on financial benchmarks in Australia, its aim for BMs to be “robust and reliable” and its focus on the use of the IOSCO Principles<sup>12</sup> to achieve these objectives. Based on our experience, we believe that the IOSCO Principles are well suited to address the key risks arising from the administration of or the contribution to BMs. We are generally supportive of ASIC’s recommendation that systemically important Australian BMs should comply with the IOSCO Principles whilst other BMs be administered in accordance with the IOSCO Principles in a proportionate manner.<sup>13</sup> Our comments aim to raise ASIC’s awareness of issues that we have identified in the course of implementing the IOSCO Principles and during our engagement in relation to benchmark regulation in various jurisdictions. Our recommendations are designed to ensure that ASIC’s approach does not disincentivise innovation in the index and benchmark sector or is overly burdensome for smaller benchmark administrators, and potentially question their viability.

Specifically we recommend that ASIC (a) takes a broader set of factors into account in its risk-based approach of classifying BMs; (b) when defining scope, it carefully consider the treatment of self-indexing, performance BMs, and in-house BMs; (c) only regard those indices as BMs where the index administrator is aware of and has provided consent to the use of its index as a BM; (d) allow for sufficient proportionality in the implementation of the IOSCO Principles, for example in relation to record keeping, audit, and governance requirements; (e) empower BM administrators to determine the most representative source of input data (which will depend on the asset class and market conditions); (f) allow for sufficient flexibility in the implementation of the Submitter Code of Conduct; and (g) ensure that any required transparency does respect existing intellectual property rights.

### 1. Relevant factors for BM classification

In the Consultation Report ASIC encourages “administrators of systematically-important benchmarks administered in Australia to adopt and implement the IOSCO principles”.<sup>14</sup> It also states that “in relation to non-

---

<sup>5</sup> The Monetary Authority of Singapore issued proposed legislation for a “Regulatory Framework for Financial Benchmarks” in July 2014. See: <http://www.mas.gov.sg/news-and-publications/media-releases/2014/mas-proposes-legislation-for-a-regulatory-framework-for-financial-benchmarks.aspx>

<sup>6</sup> IOSCO Consultation Report: Financial Benchmarks. January 2013. Markit letter to IOSCO regarding the consultation report (11 Feb. 2013) available [here](#).

<sup>7</sup> 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](#).

<sup>8</sup> FSA Consultation Paper: The regulation and supervision of benchmarks. Markit letter to the FSA regarding consultation paper (16 January 2013) available [here](#).

<sup>9</sup> See : <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf>

<sup>10</sup> On July 14<sup>th</sup> 2014 Markit announced its commitment to administer its benchmark products in compliance with the IOSCO Principles and implement the relevant policies and procedures before the end of 2014.

<sup>11</sup> On December 3<sup>rd</sup> 2014 Markit announced that it has completed implementation of the IOSCO Principles compliance framework which includes an Administrator Code of Conduct (“ACoC”), a governance and oversight structure, conflict of interest policies, the publication of benchmark methodologies and the Submitter CoC (“SCoC”). For this statement and the statement in (9) above see:

[http://www.markit.com/Content/Documents/Products/Disclosures/IOSCO\\_Compliance\\_disclosure.pdf](http://www.markit.com/Content/Documents/Products/Disclosures/IOSCO_Compliance_disclosure.pdf)

<sup>12</sup> See CR para. 14

<sup>13</sup> See CR para. 155

<sup>14</sup> See CR para. 154

systematically important benchmarks, we consider that misconduct risk can be mitigated if administrators of these benchmarks apply the IOSCO Principles in a proportionate manner”.<sup>15</sup>

We welcome ASIC’s two-tiered, risk-based approach to benchmark regulation in Australia. We believe that, given the variety of existing benchmarks, the use of proportionality in BM regulation is of crucial importance, and a risk-based approach will be instrumental to achieving this objective. However, we recommend that ASIC in its “classification” of a BM into a specific “risk category” not just reflect the systemic importance of a BM but a wider set of factors. Specifically, we believe that relevant factors are: (a) the systemic importance of the BM,<sup>16</sup> (b) the BM’s susceptibility to manipulation;<sup>17</sup> (c) the availability of alternatives to the BM and the ability of users to switch to one of those if they desire; and (d) current controls and oversight of the BM production.<sup>18</sup>

## 2. Scope

The definition of “benchmark” as established by IOSCO results in a wide scope and, we have found, does benefit from clarification in several aspects. We believe that the overall goal, when setting the scope of BM regulation, should be to clearly capture “risky benchmarking activities” that are identified based on the above risk-based approach while, at the same time, ensuring that the resulting scope is not excessive without corresponding benefit. On that basis we recommend ASIC consider the following issues:

### - Self-indexing

ASIC states in its recommendations for “wealth managers and other clients”<sup>19</sup> that, “to the extent that wealth managers (or their related entities) also administer benchmarks, our recommendations for benchmarks administrators will be relevant”.

We welcome ASIC’s recognition of the activity of “self-indexing” to be within the scope of the regulation.<sup>20</sup> We believe that investment managers who create and administer indices that they then use to measure their own performance are subject to conflicts of interest that will need to be identified and appropriately managed. Including such types BMs within the scope of the regulation can ensure that they are maintained to the same high standards as other BMs.<sup>21</sup>

### - Performance benchmarks

ASIC states that “performance benchmarks and indices referenced in ETFs, managed funds and managed investment schemes” would likely fall in scope.<sup>22</sup>

We agree that indices referenced in ETFs should be in scope as long as such indices have a direct impact on the payments of these ETFs. However, we believe that the inclusion of performance benchmarks in scope is not appropriate. This is because BMs that are used solely to measure the performance of an investment fund

---

<sup>15</sup> See CR para. 155

<sup>16</sup> The extent to which a BM is widely referenced in financial instruments taking into account notional outstanding and number/type of users. See CR para. 45

<sup>17</sup> 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 many fixed income or equity 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 limited number of contributions.

<sup>18</sup> For example, whether the BM and the parties that are involved in the benchmarking process already comply with a Code of Conduct or similar policies and procedures based on market forces.

<sup>19</sup> See CR para. 158, 159, 160

<sup>20</sup> See CR para. 160

<sup>21</sup> It will also prevent their administrators from having an unfair competitive advantage.

<sup>22</sup> See CR para. 34

have a significantly lower risk associated with them. Specifically, the incentives and ability to manipulate these BMs are limited because users and contributors to these indices are not the same and most of these indices have a broad nature, i.e., they are calculated based on the prices of hundreds, if not thousands of underlying assets.<sup>23</sup> ASIC should also consider that the inclusion of performance BMs would massively increase the number of BMs that are in scope, herewith significantly raising the need for supervisory resources with little corresponding benefit.

#### - **In-house benchmarks**

ASIC's comments in relation to its ongoing review of BM related conduct<sup>24</sup> and its recommendations for dealers<sup>25</sup> do not seem to be very specific in relation to scope. We suspect ASIC mostly refers to dealers' contributions to established, public BMs such as the IBORs.

In this context, it might be helpful for ASIC to consider the findings of the UK FCA's recent Thematic Review on banks' benchmarking activities.<sup>26</sup> In its report the FCA states that "there was inconsistency in how firms determined the range of benchmark activities within the firm and how change programmes and lessons learnt from previous benchmark failures were applied across business areas." Specifically, "some firms chose to interpret the IOSCO definition of benchmarks such that it did not fully encompass their strategic in-house benchmark business. As a consequence, firms did not give sufficient consideration to establishing a relevant governance framework around their in-house benchmark business." It might be helpful for ASIC to clarify its approach to the administration of "in-house benchmarks".

#### - **Provision of consent**

Many indices will not be classified as benchmarks under the IOSCO Principles as that they are not referenced in financial contracts.<sup>27</sup> However, with many of these indices being published, it is possible for anyone to reference these BMs in a financial instrument. We are concerned that such action by a third party that might occur without receiving a license from or even the knowledge<sup>28</sup> of the index administrator would turn the index into a BM and, in the extreme, make the index administrator a regulated BM administrator.

To prevent such situations an index should be regarded as a BM only if the administrator is aware of the use of the index as a BM and has provided its consent to this use.

### **General issues**

Based on our experience with the implementation of the IOSCO Principles we urge ASIC to consider the following issues when designing a regulatory framework and setting its supervisory expectations for benchmark administration in Australia:

#### **1. Proportionality of the requirements**

---

<sup>23</sup> Also, the financial incentive for the asset manager to manipulate the BM in order to receive a higher performance fees is significantly less than having a favourable cash payout on a financial contract that may arise from manipulating the benchmark that is referenced in the contract.

<sup>24</sup> See CR para. 45

<sup>25</sup> See CR para. 134

<sup>26</sup> [TR15/11: Financial Benchmarks: Thematic Review of Oversight and Controls](https://www.fca.org.uk/your-fca/documents/thematic-reviews/tr15-11). See <https://www.fca.org.uk/your-fca/documents/thematic-reviews/tr15-11>

<sup>27</sup> For a detailed definition of a Benchmark under IOSCO principles, see ANNEX A Glossary of Key terms (pp.35) in the IOSCO Principles for Financial Benchmarks Final report [here](#)

<sup>28</sup> For examples, Markit publishes the levels of its major iBoxx, ITraxx and CDX indices on its website on a daily basis.

We agree with ASIC's approach of proportionate implementation of the IOSCO Principles for non-systemically important BMs. We believe that it will be important that such proportionality can be applied across the whole range of the Principles where appropriate. Examples include:<sup>29</sup>

- **Principle 3: Conflict of interest for Administrators** – a requirement for separation of staff of administrators (physically or operationally) could be overly costly and onerous, particularly for smaller administrators. It should only be expected only for systemically important BMs;
- **Principle 17: Audit** – BM administrators are required to have an auditor to periodically review and report on their adherence to the Principles; where appropriate, the administrator should appoint an independent external auditor. We believe that, given the significant costs involved, an external audit should only be required for systemically important BMs, not for administrators with a more limited or less complex BM business.
- **Principle 18: Audit Trail** – BM administrators are required to keep records of written and phone communications, methodology and input data with respect to the BM determination. Expecting full implementation of this requirement could be costly for smaller administrators and disproportionate to the risks posed by them.

## 2. Input Data

The IOSCO Principles state that the data 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 in order to provide confidence that the price discovery system is reliable”<sup>30</sup> and also that non-transactional data may be used only as an “adjunct or supplement to transaction data” for the determination of BMs.<sup>31</sup>

While the IOSCO Principles provide some flexibility regarding the type of input data that is used beyond transaction data,<sup>32</sup> we have found that further clarification is useful. Experience has shown that reliable BM levels can be more easily determined in asset classes where the underlying instruments trade continuously, while more effort is required 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 of BMs and indices. We generally support the use of an input data hierarchy that contains several data sources, including various forms of non-transactional data, while allowing for the use of expert judgment, where appropriate.

However, we believe that any requirement for all BMs to be “anchored in transactions” would be misguided and could result in severe unintended consequences. Based on our experience, representative BMs cannot be produced based solely on transactions in asset classes or product categories where transactions occur only on an infrequent basis, transaction prices are not publicly available or not representative. As a consequence, the use of alternative information sources and expert judgment are essential to construct and calculate these BMs in a reliable and accurate manner. We therefore urge ASIC to provide administrators with sufficient flexibility to choose the type of input data that is most representative depending given the asset class and market conditions. Administrators should be transparent to benchmark users about which data sources they mostly rely on and the methodology they use to identify the most representative data sources.

## 3. Submitter Code of Conduct

---

<sup>29</sup> Markit's view is that any approach to proportionality should be accompanied by sound reasoning and also proper documentation.

<sup>30</sup> IOSCO Principle 7: Data Sufficiency

<sup>31</sup> IOSCO Principle 7: Data Sufficiency

<sup>32</sup> IOSCO Principle 8: Hierarchy of Data Inputs

For BMs that are based on submissions, the IOSCO Principles require that input data should be accepted only from entities that adhere to the Submitter Code of Conduct (“**SCoC**”). BM administrators would be required to monitor submitters’ compliance with the SCoC and “ensure” compliance whilst submitters themselves would need to establish the relevant internal policies, systems and controls.

ASIC should note that, if BM administrators were required to implement a demanding, legally binding SCoC with all of their submitters, it is likely to harm the quality (and in the extreme even the availability) of submission-based BMs across asset classes. This is because submitters to BMs provide their contributions mostly on a voluntary basis. Any requirement for BM submitters to sign a SCoC and for BM administrators to “ensure” the submitter’s adherence to code of conduct creates a risk that the submitters withdraw their submissions altogether and would expose administrators to significant monitoring costs. This issue will be particularly acute in less liquid asset classes and where Submitters are unregulated entities. It could lead to reduced transparency and increased risks in financial markets.

We therefore urge ASIC to allow for a proportionate application of the Code of Conduct. Specifically, BM administrators would provide a SCoC to their submitters, require compliance with it, and make reasonable efforts to monitor such compliance.

#### 4. Transparency

IOSCO Principle 9, Transparency of Benchmark Determinations, requires BM administrators to publish, with each BM determination, a concise explanation sufficient to facilitate the subscriber’s or Market Authority’s ability to understand how the BM determination was developed. Certain jurisdictions<sup>33</sup> have also proposed requiring the BM administrator to provide transparency of input data and benchmark methodology to the public.

We believe that such requirement would often be in conflict with existing intellectual property rights of the BM administrator and would have a chilling effect on innovation. We believe that more tailored transparency requirements that respect existing IP rights are more appropriate while more granular transparency should be provided to regulators on request.

\* \* \* \* \*

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

Yours sincerely,



Marcus Schüler  
Head of Regulatory Affairs  
Markit  
[marcus.schueler@markit.com](mailto:marcus.schueler@markit.com)

<sup>33</sup> The EU benchmark proposals by the European Commission (EC), the European Council (Council) and the European Parliament (EP) vary in their requirements on transparency of input data and methodology. See Art. 7, 16 (EC), Art. 7b (Council) and Art. 7b (EP)