



Principles for Financial Benchmarks

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INTRODUCTION

Financial benchmarks are widely used as references for determining payments under a variety of financial instruments and many have a significant impact on market activity globally. The integrity of these benchmarks is critical to the effective functioning of markets and investor confidence.

Recent events have placed the integrity of some of the most significant benchmarks into question and have contributed to public distrust in the financial industry. These events have prompted policy-makers to study enhancements to the benchmark-setting process. For instance, the United Kingdom's Chancellor of the Exchequer commissioned *The Wheatley Review* to focus on the reforms to the framework for setting the London Interbank Offered Rate. The final report¹ of this review was published on 28 September 2012. The International Organization of Securities Commissions (IOSCO) published its final Principles for Oil Reporting Agencies² on 5 October 2012, in response to a G20 Leaders' request to enhance the reliability of oil price assessments. Both the European Union and IOSCO are currently conducting wide-ranging reviews of financial benchmarks in general.

A broadly accepted set of best practice standards for conducting benchmark price assessment processes ("benchmark process") would serve to enhance confidence in such assessments and, more generally, promote both the integrity and efficiency of the global financial markets.

¹ http://cdn.hm-treasury.gov.uk/wheatley_review_libor_finalreport_280912.pdf

² <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD391.pdf>

The Global Financial Markets Association³ (“GFMA”) has three objectives in issuing these *Principles for Financial Benchmarks* (the “Principles”):⁴

- To draw attention to the need for international standards that apply to the issuance of financial benchmarks;
- To offer the Principles as a basis for crafting such international standards; and
- To urge the adoption of the Principles by organizations responsible for developing and issuing benchmarks.

GFMA particularly welcomes the reviews of the regulatory framework for financial benchmarks by the global regulatory community. GFMA recommends that these reviews should be coordinated globally to ensure consistency and encourages the regulatory community to consider the enclosed Principles as a basis to guide the development of a regulatory regime. GFMA suggests that a regulatory regime should adopt the following concepts:

- All systemically significant financial benchmarks should be subject to regulatory oversight.
- To ensure that regulation is appropriately scaled and targeted, where a benchmark sponsor or other participant is already regulated by a financial regulator, then that regulator should oversee the implementation of the agreed-upon standards within the entity, in a manner that reflects the significance of the benchmark being regulated.
- Where no financial regulator has jurisdiction over a sponsor or other benchmark participant, GFMA recommends that appropriate administrative or legislative steps should be taken to ensure application of the standards to all participants in the benchmark process, also in a manner that reflects the significance of the benchmark.

³ The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, visit <http://www.gfma.org>.

⁴ The Principles were issued in preliminary form in September 2012, based on input from GFMA affiliates and member institutions. The refinement of the Principles to their current form was based on feedback from a broad variety of benchmark industry participants and informed by the publication of a number of regulatory reports, including those from the Wheatley review and IOSCO.

- Finally, GFMA notes that any new regulation should be developed consistently across jurisdictions, avoiding duplication, and defining clear regulatory responsibilities for oversight of individual benchmarks.

DEFINITIONS

Benchmarks

The types of financial benchmarks vary widely, in terms of the participants involved in developing and issuing benchmarks, determination methods, and in the uses and significance of the benchmarks.

For the purposes of the Principles, a **benchmark** will be defined as a commercial or published price assessment, distributed regularly to third parties and extensively used as a reference in determining the pricing of, or the amount payable pursuant to, a financial instrument or contract. Benchmarks may be established from the market prices or rates for transactions in debt or equity securities, the foreign exchange, money and commodity markets, or derivatives of any of these.

Operating Models

Operating models for designing, operating and publishing benchmarks vary considerably across markets. The key roles are normally divided between functions undertaken by the sponsor or its agents, on the one hand, and the entities that provide market data to allow the determination of the benchmark, on the other. There is no standardization of terminology, but for the purposes of the Principles, the participants in a benchmark process will be taken to comprise:

- **Sponsor:** an entity or group that develops and directs the determination, publication and possibly licensing of a benchmark;
- **Licensing Agent:** an agent or division of the sponsor responsible for licensing the benchmark for use by financial product providers, trading venues or clearing organizations;
- **Publisher:** an agent or division of the sponsor, or third party licensed by the sponsor, responsible for the regular dissemination of the benchmark to subscribers and/or the general public;

- **Calculation Agent:** an agent or division of the sponsor responsible for collecting inputs from market data sources and for using this data to conduct a benchmark price determination;
- **Market Data Sources:** Benchmarks may be determined based on a spectrum of market inputs, including but not limited to prices at which market transactions occur, price estimates from market participants, price observations from related markets or consolidated price or transaction data from trading venues and clearing houses. Combinations of information from such sources may also be used to arrive at a final benchmark determination or for back-testing the quality of a benchmark. For the purposes of the Principles, two specific data sources are highlighted:
 1. **Contributor:** an individual market participant that provides data to the calculation agent for the purpose of conducting a benchmark price assessment. An individual bank providing price quotations for a survey-style benchmark would be an example.
 2. **Consolidator:** an entity that provides an aggregation of price or transaction data across multiple individual market participants to the calculation agent for the purpose of determining a benchmark. A stock exchange providing closing prices would be a typical example.

Single entities may play a number of the above roles. For example, a division of the sponsor may also act as a market data source, while many of the operational roles may be carried on within a sponsor entity. The Principles recognize such variation in operating models by allowing for various governance, control and conflict management mechanisms to be implemented as appropriate to the particular process or operating model.

SCOPE

The Principles are intended to apply broadly to benchmarks across asset classes and operating models. The key criterion for bringing a benchmark within the scope of the Principles is its use in determining the price of or payments under financial contracts. Benchmarks may evolve from a variety of sources, for example as market level indicators or analytic measures for assessing portfolio performance. Nonetheless, once a benchmark is used as a reference for contract pricing, it should be considered to fall within the scope of application of the Principles.

There are some exceptions to application of the Principles. First, indices that are primarily used

for purposes other than pricing financial instruments or contracts are excluded from scope. Examples include indices that are used primarily for the purpose of evaluating the returns or other performance characteristics of asset portfolios, and economic or market sentiment indices produced by private sector organizations. Second, customized indices used for pricing bespoke bilateral or similar transactions among a limited number of counterparties are excluded. Examples include customized or privately-negotiated indices, reference portfolios or baskets, defined in connection with issuances of structured notes, with bespoke transactions to effect investment strategies, or with similar bilateral or limited arrangements. Finally, indices issued by public sector entities are out of scope. Examples include economic indicators or other statistics published by government entities, even if some, such as inflation indices or weather data, are widely used in the pricing of financial instruments.

The Principles embody many general concepts, such as the need for clear governance, sound methodologies and practical control standards. Sponsors of benchmarks should evaluate their operations against the Principles and adapt the general governance and control provisions as appropriate to the specific design and significance of the benchmark.

PRINCIPLES FRAMEWORK

The overall responsibility for the benchmark process lies with the sponsor. The Principles are grounded in three fundamental sponsor obligations, which should be applied in a manner commensurate with the significance of the benchmark:

- **Governance:** A sponsor should ensure that there is an appropriate governance structure for oversight of the benchmark;
- **Benchmark Methodology and Quality:** A sponsor should employ sound design standards in devising the benchmark and ongoing processes related to its operations; and
- **Controls:** A sponsor should ensure that there is an appropriate system of controls promoting the efficient and sound operation of the benchmark process and should implement such a system of controls.

The Principles are grouped into three sections under the above headings accordingly.

THE PRINCIPLES

1. GOVERNANCE

PRINCIPLE I: OVERALL RESPONSIBILITY

A sponsor is ultimately responsible for the quality and integrity of a benchmark.

A sponsor should appoint and appropriately empower a governance body accountable for the development, issuance and operation of the benchmark. The nature of the governance body may vary depending on the benchmark and may comprise a formal board, a dedicated committee or an individual manager. In all instances, however, it is essential that there be a single identifiable authority with specific accountability for the sound operation of the benchmark.

The responsibilities of the governance body include overseeing the benchmark methodology, the control framework, and the relationships between the sponsor and any third parties. The governance body should oversee the management responsible for operation of the benchmark, take appropriate measures to remain informed about material issues and risks related to the benchmark, and commission periodic independent internal or external reviews to oversee that the benchmark continues to operate in accordance with the Principles.

While retaining ultimate authority for the benchmark, the sponsor should encourage input from stakeholders and should develop governance structures or processes for receiving and evaluating such input.

PRINCIPLE II: CLEAR ROLES AND RESPONSIBILITIES

A sponsor should define clearly the roles and responsibilities of the participants in the benchmark process.

A sponsor may enter into an agreement with a third party to act as its agent in calculating the price assessment, distributing the price assessment data, or licensing the benchmark. A sponsor should establish clear roles and responsibilities for any third party charged with acting on the sponsor's behalf.

In the case where the benchmark process relies upon individual contributors to provide the sponsor or sponsor's agent with market data or estimates, the sponsor should ensure that there

are clear standards for contribution of data or estimates and ensure transparency regarding the nature of such participation for the end users of the benchmark. Such standards for contributors should be specified by the sponsor in a documented contributor code of conduct, as described in Principle IX.

Where a benchmark relies upon data from a consolidator, the sponsor will typically be reliant on the consolidator's controls for the integrity of the data so sourced. The sponsor should take reasonable steps to ensure that the consolidator has implemented and operates an appropriate control environment. Where the sponsor has a contractual relationship with the consolidator, the roles of each party with respect to the maintenance of data integrity should be clearly articulated.

Where one or more of the functions in the benchmark process are carried out within a broader organization, the sponsor should ensure that there are policies and procedures to identify and manage conflicts of interest arising either between the various benchmark functions or between the benchmark functions and the activities of the broader organization.

PRINCIPLE III: TRANSPARENCY

A sponsor should operate with transparency with respect to benchmark development and changes, taking due account of impacts on process participants and anticipated end users.

Specifically, the sponsor should make the methodology for determining a benchmark available to those parties that the sponsor can identify as being affected by the benchmark, provide such parties with notice of any proposed amendments to the methodology for determining a benchmark price assessment and ensure that there is a process for receiving and responding to any comments on these proposed amendments.

The sponsor should also ensure that there are procedures for the communication, management and timely resolution of complaints related to the benchmark process. The sponsor should make available the complaint procedures to those parties that the sponsor can identify as being affected by the benchmark. In the case of benchmarks using contributor data, the sponsor should provide a contributor with appropriate notice if the sponsor determines that a contributor is violating the contributor code of conduct. Any disputes should be handled in accordance with an appropriate dispute resolution process.

The sponsor should also make available the policies and procedures, required under Principle VI, for identifying and managing conflicts of interests to those parties that the sponsor can identify as being affected by the benchmark.

2. BENCHMARK METHODOLOGY AND QUALITY

PRINCIPLE IV: METHODOLOGY

A sponsor should ensure that there is a methodology for conducting the benchmark price assessment that relies on sound data and accurately reflects market conditions.

This methodology should:

- Define clearly the technical specifications for the benchmark;
- Be clearly documented;
- Describe the manner in which the sponsor determines the benchmark, including the responsibilities of any third parties, such as calculation agents and contributors, as well as the procedures and criteria for the application of judgment by sponsor personnel in determining the benchmark price assessment and for addressing periods where the quantity or quality of data falls below the standards set by the methodology;
- Use sound and transparent data. Where feasible, a sponsor's methodology for determining a benchmark price assessment should give primacy to data reflecting either executed transactions into which unrelated counterparties acting at arm's length have entered in such sizes and upon such other terms as the sponsor may define, or executable bids and offers to enter into such transactions.

Where such information is sparse or unavailable, a sponsor may rely on other methods for assessing prices, including dealer quotes, mathematical models that predict prices based on the observed prices of other products, good faith estimates, contributor surveys, or other methods. The sponsor's benchmark process should not be overly reliant on data from a narrow range of contributors, and should be sufficiently resilient to allow for a benchmark price assessment in the event of limited liquidity in the underlying market or market segment. Under such circumstances of limited liquidity, the sponsor should have particular regard to transparency obligations in identifying how the benchmark assessment is reached.

- Permit the sponsor or the calculation agent to exercise appropriate judgment in respect of data analysis, modeling and calculation methods to promote the integrity of the

assessment.

PRINCIPLE V: BENCHMARK QUALITY

To promote the quality of a benchmark over time, a sponsor should follow best practice design elements.

Those elements include the following:

- There should be sufficient trading activity in the underlying or closely-related markets on which the benchmark is based to allow a reasonable and regular price assessment to be made.
- The trading activity in the underlying market should be conducted in such a manner and among a sufficiently broad group of participants so as to allow for transparent price discovery.
- The terms of contracts and participants to the underlying transactions upon which the benchmark is based should share sufficiently similar characteristics to minimize idiosyncratic distortion to the benchmark over successive assessments.
- While the sponsor cannot control all of the uses for which a benchmark may be employed by third parties, the design of the benchmark should reflect the broad terms of financial instruments and contracts for which it is generally intended to be used as a reference rate.

The sponsor should periodically review the benchmark design and calculation methodology, as well as the nature of activities in the underlying market, to promote continued adherence to sound design elements and reflection of market conditions. The sponsor should make the results of these periodic technical reviews available to licensed users of the benchmark, or to the general public when a benchmark is used extensively.

3. CONTROLS

PRINCIPLE VI: CONTROL FRAMEWORK

A sponsor should ensure that there is an appropriate control framework for conducting and maintaining the benchmark process and for distributing the benchmark price assessment.

At a minimum, this framework should cover:

- The engagement of suitably qualified and experienced personnel to carry out the sponsor's responsibilities;
- Appropriate periodic training, including technical and ethics training;
- Policies and procedures relating to the identification and management of conflicts of interest (including through disclosure). Such policies and procedures should take into account conflicts arising from the other activities of the sponsor, the calculation agent, or contributors;
- Policies and procedures for safeguarding confidential information, including confidential information received from contributors, and controls to prevent the premature, unauthorized or preferential disclosure of information concerning a benchmark price assessment;
- Policies and procedures for receiving, investigating, reporting, and documenting complaints or potential errors with the sponsor's benchmark price assessment, including a process for escalating complaints, as appropriate, to the sponsor's governance body;
- Policies and procedures to ensure that emerging issues that may affect market integrity are brought promptly to the attention of the appropriate regulators;
- Policies and procedures applicable to violations of the sponsor's procedures by the sponsor's personnel or agents, or of the contributor code of conduct by individual contributors. Such procedures should include appropriate reporting mechanisms to the sponsor's governance body, and clarity on the process for adjudication for violations;
- Policies and procedures for identifying anomalous data received from market data sources, excluding such data from the benchmark process, and taking appropriate remedial actions to minimize the possibility of recurrence;
- Procedures to notify end users promptly of errors and corrections in a benchmark price assessment;
- An infrastructure, with appropriate resiliency, reflecting the significance and criticality of

the benchmark to the marketplace, and a process for the periodic testing of this infrastructure; and

- A contingency plan for conducting the benchmark price assessment in the event of the absence of data from the normal market data sources, market disruptions, failure of critical infrastructure, or other factors. The contingency plan should be operationally distinct from the normal determination process.

PRINCIPLE VII: INDEPENDENT REVIEW AND RECORD-KEEPING

The sponsor should ensure that the benchmark process and methodology are subject to a periodic review of controls by an independent internal or external party. Appropriate documentation of the benchmark process should be maintained to support the review.

Such reviews, commissioned by the sponsor's governance body, may be conducted by a sponsor's independent internal control function, by the sponsor's external auditor or by an independent third party, as appropriate to the scope of the benchmark and organization structure of the sponsor. For benchmarks that are used extensively in the marketplace, the review should be conducted by a third party.

The independent review should assess the sponsor's adherence to the established methodology for determining the benchmark and the control framework relating to the benchmark in light of the Principles. The sponsor should be able to confirm that periodic independent reviews have been conducted, that any necessary remedial measures have been taken and that appropriate parties have been advised as needed of matters arising from the review.

A sponsor, or by delegation, the sponsor's calculation agent, should maintain documentation and keep records (for a period defined by the sponsor commensurate with the significance of the benchmark) showing all inputs to the benchmark price assessment, the application of these inputs to determine the final benchmark price assessment, and the methodology utilized, as appropriate.

Such documentation should include an explanation for the sponsor's or the calculation agent's exercise of judgment, the disregard, if any, of observed transaction or contributor data, and descriptions of any pricing models defined in the methodology.

PRINCIPLE VIII: DATA COLLECTION

A sponsor should ensure that there are appropriate controls over the process for collecting data for use in a benchmark price assessment.

Where a sponsor uses data collected directly from a market data source, either an individual contributor or a consolidator, these controls should include a process for selecting the source, collecting data from the source, protecting the confidentiality of the source's data, evaluating the source's data submission process, and removing or applying other sanctions for non-compliance against the source, where appropriate.

PRINCIPLE IX: CONTRIBUTOR CODE OF CONDUCT

Where the benchmark price assessment requires the submission of data by a third party individual contributor, a sponsor should ensure that there are standards for contributions, specified in a contributor code of conduct, and contributors should employ appropriate controls over data submissions.

The contributor code of conduct should cover, at a minimum, the following:

- The existence of a governance structure that promotes integrity among the contributor and its personnel and associated policies and procedures governing the data submission process;
- Policies and procedures relating to the identification and management of conflicts of interest (including through disclosure), including protections against insider trading, segregation of responsibilities where practicable, and informational firewalls, as appropriate;
- Policies and procedures prohibiting the coordination of, or sharing of information regarding, contributor data submissions with other contributors;
- The engagement of suitably qualified and experienced personnel, including supervisors, to carry out the contributor's responsibilities;
- The clear definition of roles and responsibilities for contributor personnel associated with the data submission process;

- Appropriate periodic training, including technical and ethics training;
- An appropriate monitoring and testing process for reviewing that data communicated to a sponsor or a calculation agent are consistent with the sponsor's methodology and the contributor's policies and procedures. In cases where transaction data are used to inform contributor quotes or are being submitted directly to the calculation agent, clear criteria should be established to ensure that there is no unjustified filtering of the transactions for which the data are provided.
- Policies and procedures for receiving, investigating, reporting, and documenting complaints relating to the contributor's data submissions;
- Policies and procedures applicable to violations of the contributor's policies and procedures relating to the contributor's role in the benchmark process. Such procedures should include appropriate reporting mechanisms to the contributor's governance body;
- Controls for the protection of confidential information;
- An infrastructure, with appropriate resiliency, to support the timeliness and accuracy of submissions, and periodic testing of this infrastructure;
- A contingency plan for submitting data due to a failure in the infrastructure or other factors, where practicable;
- An appropriate notice period to be given to the sponsor by the contributor before a withdrawal from the contribution process in order to avoid precipitate disruption to the benchmark determination;
- A process for retaining records relating to data provided to a sponsor, including documentation deemed the most relevant by a contributor in its assessment, in a form which facilitates subsequent review; and
- A periodic independent internal or external review of the contributor's data submissions and control framework.

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