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7 September 2012

Commissioner Michel Barnier  
European Commission  
Brussels  
Belgium

Ms. Arlene McCarthy MEP  
European Parliament  
Bât. Altiero Spinelli  
Brussels  
Belgium

Chairman Mark Carney  
Financial Stability Board  
Bank for International Settlements  
Centralbahnplatz 2  
CH-4002 Basel  
Switzerland

Mr. Martin Wheatley  
The Wheatley Review  
HM Treasury  
1 Horse Guards Road  
London SW1A 2HQ  
United Kingdom

Governor Mervyn King  
Bank of England  
Threadneedle Street  
London SW1A 2HQ  
United Kingdom

Secretary General David Wright  
IOSCO  
C/ Oquendo 12  
28006 Madrid  
Spain

## **Re: Principles for Financial Benchmarks**

Dear Sirs and Madam:

Recent events have called the integrity of some of the most significant global financial benchmarks, such as LIBOR, into question and have prompted numerous policy-makers to study enhancements to the benchmark-setting process. The Global Financial Markets Association<sup>1</sup> (“GFMA”) believes that the events related to LIBOR point to a need for a broader consideration of financial benchmarks used in the marketplace, and to determine what common practices need to be in place to enhance market integrity generally. We strongly believe that international standards are needed to govern issuance of financial benchmarks.

In view of this, GFMA has given high priority to developing the enclosed statement of Principles for Financial Benchmarks (“Principles”). In doing so, GFMA member firms worked to devise a

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<sup>1</sup> 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>.

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

We welcome the review of the regulatory framework for financial benchmarks by the global regulatory community. GFMA recommends that this review 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 prudential 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.
- 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.

\* \* \*

GFMA believes it is critical to the smooth functioning of global financial markets for significant benchmark indices to be subject to uniform, transparent, and sound practices. Developing these principles has been a cooperative effort among our member firms and we would welcome the opportunity to work with the regulatory community on moving forward in this important effort.

Sincerely,

A handwritten signature in black ink, appearing to read "Simon Lewis". The signature is fluid and cursive, with the first name "Simon" written in a larger, more prominent script than the last name "Lewis".

Simon Lewis  
CEO, GFMA

Attachments:

- Annex 1: Principles for Financial Benchmarks
- Annex 2: CC List



# Principles for Financial Benchmarks<sup>1</sup>

*07 September 2012*

## 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 International Organization of Securities Commissions has been reviewing the need for such principles in the crude oil markets.

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.

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<sup>1</sup> In view of the understandably tight timescales set for public comment in response to current regulatory reviews of benchmarks, the Global Financial Markets Association (GFMA) is sharing these Principles as currently formulated with the appropriate governmental and regulatory bodies. However, GFMA plans to test the detailed application of the Principles over the coming weeks and may revise or clarify the formulation based on this work.

In this context, the Global Financial Markets Association<sup>2</sup> (“GFMA”) is issuing these *Principles for Financial Benchmarks* (the “Principles”). Our objectives in doing so are the following:

- 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.

The Principles recognize that benchmarks and their data inputs necessarily vary by market and reference asset type, and that many benchmarks inevitably rely on voluntary contributors and their judgment. Nonetheless, sponsors and their agents are encouraged by the Principles to solicit sufficiently deep or broad-based reference data while maintaining the integrity of the submission process and resulting benchmark price assessment.

## **SCOPE AND DEFINITIONS**

The types of financial benchmarks vary widely, both in terms of the participants involved in developing and issuing benchmarks 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 primarily intended for use as a reference in determining the pricing of, or the amount payable pursuant to, a financial instrument or contract. Thus, 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.

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<sup>2</sup> 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>.

For clarity, the Principles are not intended to apply to benchmarks meeting one or more of the following exclusion criteria:

### **1. Use**

***Indices that are primarily used for purposes other than pricing financial instruments or contracts are out of 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.

### **2. Scale**

***Customized indices used for pricing bespoke bilateral or similar transactions among a limited number of counterparties are out of scope.***

Examples include customized or privately-negotiated indices, reference portfolios or baskets, defined in connection with specific issuances of structured notes, with bespoke transactions to effect investment strategies, or with similar bilateral or limited arrangements, for which no third parties contribute data directly and for whose use no license fee is charged.

### **3. Public Source**

***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. These examples would also be excluded under the use test.

Although operating models for designing, operating and publishing benchmarks vary considerably across markets, the Principles are intended to apply to as broad a variety of models as practicable over the range of benchmarks within scope. The common elements of operating models generally comprise:

- Sponsor - an entity or group that develops and issues a benchmark.<sup>3</sup>

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<sup>3</sup> Many sponsors issue multiple benchmarks. The term “benchmark” should be read in this document to mean “benchmarks”, where appropriate.

- Calculation Agent - an agent of the sponsor responsible for conducting a benchmark price assessment.
- Contributor - an entity that provides data to the sponsor or the calculation agent for the purpose of conducting a benchmark price assessment.

The calculation agent may be an internal division of the sponsor or a third party contracted by the sponsor. A division of the sponsor may also act as a contributor. 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.

## **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.

#### 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 addition, in the case where the process relies upon 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 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 significant weight 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.

### 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 contributors. Such procedures should include appropriate reporting mechanisms to the sponsor's governance body;

- Policies and procedures for identifying anomalous data received from contributors, 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 due to the absence of data from contributors, market disruptions, failure of critical infrastructure, or other factors.

#### **PRINCIPLE VII: RECORD-KEEPING AND INDEPENDENT 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.

The process and methodology documentation, and the regular operational records, should be subject to a periodic review by a party independent of the benchmark process. 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.

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.

#### **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 contributor, these controls should include a process for selecting the contributor, collecting data from the contributor, protecting the confidentiality of the contributor's data, evaluating the contributor's data submission process, and removing or applying other sanctions for non-compliance against the contributor, where appropriate.

#### **PRINCIPLE IX: CONTRIBUTOR CODE OF CONDUCT**

**Where the benchmark price assessment requires the submission of data by a third party 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;
- 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;
- 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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The following Institutions have also been copied:

### **Australia**

Auditing and Assurance Standards Board (AUASB)  
Australian Accounting Standards Board (AASB)  
Australian Prudential Regulation Authority (APRA)  
Australian Securities and Investments Commission (ASIC)  
Australian Transaction Reports and Analysis Centre (AUSTRAC)  
Financial Reporting Council (FRC)  
Financial Reporting Panel (FRP)  
Reserve Bank of Australia (RBA)

### **Austria**

Financial Market Authority (FMA)

### **Belgium**

Financial Services and Markets Authority (FSMA)

### **China**

Ministry of Commerce  
National Association of Financial Market Institutional Investors (NAFMII)  
The China Banking Regulatory Commission (CBRC)  
The China Insurance Regulatory Commission (CIRC)  
The China Securities Regulatory Commission (CSRC)  
The National Development and Reform Commission (NDRC)  
The People's Bank of China (PBOC)  
The State Administration of Foreign Exchange (SAFE)

### **Cyprus**

Cyprus Securities and Exchange Commission (SEC)

## **Denmark**

Finanstilsynet

## **European Bodies**

European Banking Authority (EBA)

European Central Bank (ECB)

European Securities and Markets Authority (ESMA)

Members of the European Commission

Members of European Parliament

## **Finland**

Finnish Financial Supervision Authority (FIN-FSA)

## **France**

Autorité des Marchés Financiers (AMF)

## **Germany**

Federal Financial Supervisory Authority (BaFin)

## **Global Bodies**

Basel Committee on Banking Supervision

G20 Finance Ministries

International Association of Insurance Supervisors

## **Greece**

Capital Markets Commission (CMC)

## **Hong Kong**

Hong Kong Monetary Authority (HKMA)  
Securities and Futures Commission  
Financial Services and Treasury Bureau

## **Hungary**

Hungarian Financial Supervisory Authority (HFSA)

## **India**

Securities and Exchange Board of India (SEBI)  
Reserve Bank of India

## **Indonesia**

Bank Indonesia  
Bapepam

## **Ireland**

Central Bank of Ireland

## **Italy**

Commissione Nazionale per le Società e la Borsa (CONSOB)

## **Japan**

Bank of Japan  
Financial Service Agency  
Securities and Exchange Surveillance Commission

## **Latvia**

Financial and Capital Markets Commission (FCMC)

## **Lithuania**

Bank of Lithuania

## **Luxembourg**

Commission de Surveillance du Secteur Financier (CSSF)

## **Malaysia**

Bank Negara Malaysia

Labuan Financial Services Authority (Labuan FSA)

Securities Commission

## **Netherlands**

Netherlands Authority for the Financial Markets (AFM)

## **Philippines**

Central Bank

Department of Finance

Securities and Exchange Commission

## **Poland**

Komisja Nadzoru Finansowego (KNF)

## **Portugal**

Comissão do Mercado de Valores Mobiliários (CMVM)

## **Singapore**

Monetary Authority Singapore

Ministry of Finance

## **Slovakia**

National Bank of Slovakia

## **Slovenia**

Securities Market Agency (SMA)

## **South Korea**

Bank of Korea

Financial Supervisory Service (FSS)

The Financial Services Commission (FSC)

## **Spain**

Comisión Nacional del Mercado de Valores (CNMV)

## **Sweden**

Finansinspektionen

## **Taiwan**

Central Bank of the Republic of China

Financial Supervisory Commission

Ministry of Finance, ROC

## **Thailand**

Bank of Thailand (BOT)

Ministry of Finance

Securities and Exchange Commission

## **United Kingdom**

U.K. Financial Services Authority (FSA)

**United States**

U.S. Commodity Futures Trading Commission (CFTC)

Board of Governors of the Federal Reserve System

Federal Reserve Bank of New York

Federal Deposit Insurance Corporation (FDIC)

Municipal Securities Rulemaking Board (MSRB)

Office of the Comptroller of the Currency (OCC)

U.S. Securities and Exchange Commission (SEC)

**Vietnam**

State Bank of Vietnam