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16 May 2013

Mr. Alp Eroglu  
International Organization of Securities Commissions (IOSCO)  
Calle Oquendo 12  
28006 Madrid  
Spain

[BenchmarkPrinciplesconsultationresponses@IOSCO.org](mailto:BenchmarkPrinciplesconsultationresponses@IOSCO.org)

**Re: Principles for Financial Benchmarks Consultation Report**

Dear Mr. Eroglu:

The Global Financial Markets Association<sup>1</sup> (“GFMA”) is pleased to provide comment on IOSCO’s Principles for Financial Benchmarks Consultation Report (the “Report”). GFMA supports the work of IOSCO in developing a framework of principles for benchmarks used extensively in financial markets and we appreciate the outreach IOSCO has undertaken with the industry in developing the Report. While GFMA considers that benchmark innovation, production and distribution should remain industry-driven activities, we believe that an internationally-agreed set of best practice standards is critical to promoting both investor confidence and the integrity of global financial markets.

As you know, GFMA developed a set of best practice standards<sup>2</sup> in November 2012, which are referenced in the Report on page three. We developed these Principles to draw attention to the need for international standards for financial benchmarks, to offer them as a basis for crafting such standards, and to urge the adoption of best practices by organizations developing and issuing financial benchmarks. We are pleased to find substantial agreement between the GFMA work and the IOSCO proposed principles. Although the Report in many instances offers more detail, the themes are closely aligned and, overall, GFMA is in broad agreement with the IOSCO proposed principles. The comments we provide in what follows are therefore aimed largely at

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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>.

<sup>2</sup> GFMA’s *Best Practices for Financial Benchmarks* at <http://www.gfma.org/correspondence/item.aspx?id=383>

clarification. We begin by providing overall comments on the Report and the proposed principles, and then provide responses to the consultation questions.

## **Overall Comments**

### **Scope**

We agree that the IOSCO principles should be designed for broad application, as are the GFMA principles. Within the broad scope, we strongly support the concept of proportional application of the IOSCO principles. Benchmarks vary widely and the specific emphasis of the principles should be tailored to the characteristics of the benchmark, the administrator, and the benchmark process. Proportionality should be assessed along such dimensions as the significance of a benchmark for the market it represents, the extent the benchmark's use in investor or retail contracts, or the susceptibility of the benchmark to manipulation.

Moreover, we suggest excluding those benchmarks from scope that clearly do not meet a minimum threshold for public policy or market impact concerns, and also making conforming changes to the definition of benchmark in the glossary. For example, in the GFMA Principles, a benchmark is defined within scope if it is used in determining the price of or payments under a financial contract, subject to some exclusions. 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, and in line with the proposed scope in the Report, 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.

We note that the IOSCO principles allow discretion to an administrator to adopt or adapt its own unique methodologies. We suggest that, consistent with the concept of proportionality, such discretion should be employable to allow benchmarks falling below a threshold of minimum impact to be excluded from full application of the principles.

## **Regulatory Implementation**

GFMA believes that the concept of proportionality should be emphasized in potential implementation of the principles by regulators. While IOSCO provides a set of factors for regulators to consider in deciding whether regulatory action is needed in order to implement the principles, it is important to state directly that decisions about whether and how to regulate benchmark activities should be proportionate to the particular characteristics of the benchmark, including its significance in the marketplace. We suggest therefore that the concept of proportionality be included in the list of factors to be considered when evaluating the need for regulation.

## **Governance (Principles 1-5)**

GFMA believes that sound benchmark practices begin with a strong governance framework. We agree that the administrator has ultimate and overall responsibility for the integrity of a benchmark. The proposed principles articulate well the components of good governance, including establishing an oversight function and clarifying the roles of, and developing procedures for, all parties involved in the process. We agree that the policies and procedures should be appropriately tailored to the potential for conflicts of interest.

We do have some suggestions for enhancements, which we detail below in the Consultation Questions section. These suggestions, briefly, are to:

- Add an explicit principle on transparency to the governance section;
- Clarify that transparency should be focused on benchmark stakeholders;
- Provide greater flexibility for how to handle reporting of potential misconduct; and
- Allow more flexibility in the structure of the administrator's oversight function.

## **Quality of the Benchmark (Principles 6-9)**

GFMA agrees that benchmarks should accurately reflect conditions in the underlying market and that the administrator is responsible for ensuring that this objective is met and maintained over time.

Regarding data input, GFMA endorses proposed Principle 8, which sets forth a hierarchy of data inputs. We agree that where data is provided by submitters, the submitters' own arms-length transactions should have primacy, followed by, in order: arms-length transactions in the underlying interest; arms-length transactions in related markets; executable bids and offers; and other information including expert judgments. However, we are concerned that the wording of Principle 7 on data sufficiency inordinately narrows the circumstances under which non-transactional data may be used. We elaborate on this point in the Consultation Questions section below.

## **Quality of the Methodology (Principles 10-14)**

GFMA agrees that it is the administrator's responsibility to ensure that there is a sound methodology, which is transparent to stakeholders. It is critical that users of benchmarks are fully informed about the inputs and process used to develop a benchmark, and any changes contemplated to those inputs and process. Users must be able to make an ongoing, informed judgment about the credibility of the benchmark and its appropriateness for the manner in which they use it or plan to use it.

We endorse the concept of a submitter code of conduct, and agree that it should be developed by the administrator and made transparent to stakeholders. We do have some suggested clarifications regarding validation of inputs, and also which function within the submitter can submit the data. We elaborate on these in the Consultation Questions section.

## **Accountability (Principles 15-18)**

GFMA agrees with the importance of holding the administrator accountable through review and complaint processes. However, instead of using the word "audit" and "auditor", we recommend that the principles call for an independent review, which, depending on the nature of the benchmark, may be able to be satisfied by an administrator's compliance department or a third party that is not an auditor. This would be consistent with the concept set forth in the Report that the application of the principles should be proportional to the particular characteristics of the benchmark, the administrator, and the benchmark process.

## **Consultation Questions**

### **1. Equity indices**

GFMA believes that equity indices should generally fall within the scope of the principles, subject to the normal provisions on proportionality or other modest exceptions excluding indices that have limited use.

When a benchmark administrator relies on a data source such as a stock exchange which aggregates data across multiple individual market participants, we believe it is appropriate for the administrator to rely on the data source's controls for the integrity of the data. However, the administrator should take reasonable steps to ensure that the data source has implemented and operates an appropriate control environment. Where the administrator has a contractual relationship with the data source, the roles of each party with respect to maintenance of data integrity should be clearly articulated.

We think that if a statement along the lines of the above is added to the principles, it would be unnecessary to identify specific principles that would not apply to this kind of situation. This is the approach taken in the GFMA Principles.

## **2. Additional measures to address risks resulting from submission-based benchmarks or ownership or control structures**

Subject to our comments in this letter, we support the measures that have been specified within the principles to address the risks arising from a reliance on data submissions. We do not see a need to exempt any specific such benchmarks, particularly since the underlying assumption is that the principles will be applied in a proportional manner.

## **3. Notice concerning use of expert judgment**

We believe administrators should provide all information that will enable stakeholders to make an informed judgment about the integrity of the benchmark and how well it represents the underlying market on which the benchmark is based. This includes defining the technical specifications clearly, and also the procedures and criteria for applying judgment. Administrators should ensure that the most recent disclosures made to stakeholders remain current. However, provided that such disclosures are readily available to stakeholders, GFMA does not see particular value in making such disclosures mandatory with each specific benchmark assessment (if this is interpreted to mean each daily or periodic publication) and believes that it may place an unnecessary cost burden on the benchmark administrator and be potentially distracting or confusing to benchmark stakeholders.

## **4. Revisions to the principles, and any other principles needed**

### ***Governance***

We believe that transparency is a key element of governance. While disclosure of various aspects of the benchmark process is appropriately included in several of the proposed principles in later sections, we believe it would convey the importance of transparency more clearly if it were also included as a broad principle in the governance section.

We also believe that transparency in this context should be directed to the benchmark stakeholders. The stakeholders would include benchmark users but not necessarily the general public, depending on the benchmark. The language of the various principles dealing with transparency uses the terms “publish” and “make public” which could be misinterpreted as full public disclosure. Full public disclosure may indeed be appropriate and required for widely-used benchmarks with systemic significance. However, the extent and timing of disclosure for any benchmark should reflect appropriate protections for intellectual property in the design of the benchmark, safeguards on confidential or market-sensitive data used in the determination of the benchmark, and a balance of the costs of extensive disclosure with the interests of the parties affected by the benchmark. While the IOSCO definitions section makes clear that the focus should be on stakeholders, we suggest that the language be clarified within the principles to lessen any possibility of misinterpretation.

Principle 4c would require a whistleblowing mechanism. We believe this may be an effective approach to facilitate early awareness of problems, but may not be necessary as long as there is a robust compliance program. We suggest therefore that this be clarified as optional.

We are concerned with this statement in Principle 5:

*Where conflicts of interests may arise in the Administrator due to its ownership structures or controlling interests, or due to other activities conducted by any entity owning or controlling the Administrator or by the Administrator or any of its affiliates: the Administrator should establish an independent oversight function which includes a balanced representation of a range of Stakeholders where known, Subscribers and Submitters, which is chosen to counterbalance the relevant conflict of interest.*

While external representation is one possible component of the governance body, we support a less prescriptive approach that would allow for other forms of governance that are suitable to the particular administrator and benchmark, provided that an appropriate control framework is in place to ensure the integrity of the benchmark.

We also believe that the form of governance should be tailored in proportion to the importance of the benchmark in the marketplace. More substantial governance structures, with extensive independent stakeholder representation, may well be required for widely-used benchmarks with systemic significance. However, less elaborate structures, provided that they are backed by an appropriate control environment, may be effective for lesser-used benchmarks, while not unduly hampering innovation or commercial viability.

### ***Quality of Benchmark***

We are concerned that the draft principles lack sufficient clarity and consistency on the question of the role that transaction data should play in benchmark design and determination.

The following statement in Principle 7 seems to emphasize that benchmark determination can only be valid when based on transaction data:

*Administrators may rely on non-transactional data such as offers and bids and adjustments based on Expert Judgment for purposes of constructing an individual Benchmark determination, but such data should only be used as an adjunct or supplement to transactional data.*

Principle 8, by contrast, introduces the data hierarchy construct, which implies that a broad variety of inputs may be used, even if primacy is given to transaction data.

GFMA believes that benchmark determination should indeed be grounded in transaction data where such data are available in sufficient volume and quality to make a determination method

feasible and robust. However, there are a wide variety of markets, across many asset classes, including corporate bonds, credit derivatives, smaller cap equities and commodities, where the frequency of transactions in the underlying instruments may be infrequent, but where a benchmark is of great value to stakeholders as an indicator of market conditions and for pricing related instruments. GFMA therefore believes that it is unnecessarily limiting to mandate that a benchmark be based solely on actual transaction data.

Accordingly, GFMA endorses the data hierarchy set forth in Principle 8 and recommends that the language in Principle 7 be clarified to avoid confusion about the extent to which non-transaction data can be used. Provided that a sufficiently robust governance and control framework is in place and there is clear transparency to stakeholders, benchmarks determined under a variety of methods can be of great value to users.

### ***Quality of Methodology***

In Principle 13, under item (g)(xi), reference is made to “*prohibitions on the submission of data from front office functions*”. We are unclear on the intent of this prohibition and are concerned that one reading of the draft principle would prevent data submissions being made by the very market participants who will have the best and most timely information regarding the markets on which the benchmark is based.

We understand the regulatory and industry concern to ensure that front-office staff that are authorized to submit data for benchmark determination should not be improperly influenced by other front office staff that trade instruments related to the benchmark and that there should be sufficient oversight of the submissions process by control functions. The risk of such influence would be minimized by such measures as segregation of duties, information firewalls and appropriate supervision. This also appears to be the approach taken in a number of recent regulatory reviews of benchmarks, including the review of LIBOR conducted by the UK FSA.

GFMA believes that sourcing submission data solely through non-front office functions could severely compromise benchmark quality and would urge IOSCO to clarify the drafting.

In Principle 13, under item (g)(v), reference is made to “*Pre-Submission validation of inputs, and procedures for multiple reviews by senior staff to check inputs*”. GFMA of course agrees with the need for appropriate input validation and process supervision. However, the draft principle as stated may be unduly onerous and operationally inefficient. We believe that the key applicable controls are, first, that the basis upon which submissions are made is recorded and available for review, and, second, that there is appropriate supervision of the submitters and testing of the process. We suggest that the draft be re-worded to focus on the control concepts, rather than prescriptive measures.

## **Conclusion**

An internationally-agreed set of principles is critical for restoring the integrity of financial benchmarks and for the smooth functioning of markets going forward. GFMA will be pleased to work with IOSCO as it finalizes the principles and works to promote adoption widely in the industry.

Sincerely,

A handwritten signature in black ink that reads "Vickie Alvo". The signature is written in a cursive, flowing style.

Vickie Alvo  
Executive Director, GFMA