

11 February 2013

Mr Alp Eroglu
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By e-mail to: benchmarksconsultationresponses@IOSCO.org

Dear Mr Eroglu

Financial Benchmarks Consultation Report

The IMA represents the asset management industry operating in the UK. Our Members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of €5.1 trillion of assets, which are invested on behalf of clients globally. These include UCITS, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our Members represent 99% of funds under management in UK UCITS. The IMA's authoritative Asset Management Survey 2012 recorded that IMA member firms were managing 38% of the domestic equity market for clients.

We welcome the opportunity to comment on the discussion and proposals made in your paper. Our answers to specific questions are attached below.

Index versus Benchmark

We would like to highlight the difference between indices and benchmarks. Indices are produced and published on a commercial basis, and are based on the price, value or amount of various financial instruments or holdings. What is defined as a Benchmark in the Glossary to your paper is actually an Index.

A benchmark is a standard against which the performance of a security, mutual fund or investment manager can be measured. Generally, broad market and market-segment stock and bond indices are used for this purpose.

Thus, an index *can* be used as a benchmark, but need not be. The definition, in the third part of section c), refers to this use of an index as a benchmark. The other two uses of the index, to price financial instruments and calculate interest due are using the index as something other than a benchmark.

Use of Indices by IMA members

Our members are users of indices as benchmarks, rather than contributors to, or producers of, indices. Nor would they normally use indices for either pricing financial instruments or calculating interest payable.

While they may use indices or combinations of indices (e.g. 50% FTSE 100, 40% MSCI Emerging Markets and 10% LIBOR) as benchmarks against which to measure the performance of a client's portfolio, they do not contribute to or produce indices themselves.

Some may take the raw data provided by an index, such as LIBOR, and perform certain adjustments to make it usable as a benchmark against which they can measure the performance of the portfolios or funds that they manage.

It is, therefore, important that the definition of an index, or Administrator created as a result of this consultation, does not catch such use of indices as benchmarks, and inadvertently impose the duties of producers of indices on those using them as benchmarks in such a way.

Market Abuse and Indices

In general, we would support the correction of any current deficiencies in indices. This may involve the wholesale, but proportionate, re-organisation of the governance of indices, placing, where appropriate (e.g. for inter-bank lending indices), the regulator at the heart of the process. Abuse of indices, either by contributors or producers should fall within the scope of the Market Abuse Regulation. International co-ordination on this and similar pieces of work is vital, given the international nature of financial services; particularly by the European Commission, ESMA and the FSB.

Inadvertent Benchmark Administration

One risk we perceive is the scope for those bodies that provide information on the financial services industry to, inadvertently, become Benchmark Administrators, solely due to the action of third parties choosing to use the information provided for one of those purposes set out in part c) of the definition. Information providers should be able, in some way, to defend themselves from the possibility that third parties could use their information in a way which was not intended and impose, as a consequence, considerable onerous and expensive burdens on them.

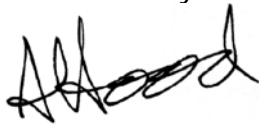
The mere fact that another entity chooses to use information that you produce, without your knowledge, permission or involvement, to price a financial instrument, should not result in your information being treated as an index, with all the resulting responsibilities and liabilities.

The proposed definition of 'Benchmark' is so wide that a wide range of data providers, including those who are not producing their information on a commercial basis, or with the intention that it may be used as a 'benchmark' will be caught by

the definition. Unless these unintentional 'benchmark administrators' are either excluded entirely from the definition or recognised as being of a different nature from those intentionally operating as 'benchmark administrators' then there could be detrimental unintended consequences, both for them and for those using the information they currently provide for purposes unconnected with the scope of this consultation.

We look forward to hearing from you if there is any clarification that you would find useful on the points we have raised. We would be happy to discuss the thinking behind any of our answers.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Adrian Hood', written in a cursive style.

Adrian Hood
Regulatory Adviser

Financial Benchmarks Consultation Report

Chapter 1: Introduction

Q1: Do you agree with the scope of the report and intended audience? Are there other Benchmarks or stakeholders that have idiosyncrasies that should place them outside of the scope of the report? Please describe each Benchmark or stakeholder and the idiosyncrasies that you identify and the reasons why in your view the Benchmark or stakeholder should be placed outside of the scope of the report.

The scope and the stakeholders seem reasonable. As we state in our cover letter: we perceive a risk that those organisations that provide information on the financial services industry may, inadvertently, become Benchmark Administrators, solely due to the action of third parties choosing to use the information provided for one of those purposes set out in part c) of the definition. Information providers should be able, in some way, to defend themselves from the possibility that third parties could use their information in a way which was not intended and impose, as a consequence, considerable onerous and expensive burdens on them.

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Chapter 2: Discussion of potential issues

Q2: Do you agree that the design of a Benchmark should clearly reflect the key characteristics of the underlying interest it seeks to measure?

Of course.

Q3: What measures should Administrators take to ensure the integrity of information used in Benchmarking-setting and that the data is bona fide? Please highlight any additional measures required where Benchmarks are survey based. Please also comment on each of the factors identified in the discussion on the 'vulnerability of data inputs' such as voluntary submission, discretion exercised by Administrators. Are these measures adequately reflected in the discussion of roles and responsibilities of the Administrator discussed in section E?

It is vital that indices are reliable. Indicators of reliability include objective, rather than subjective, input; complete, rather than partial or panel-derived, coverage; and a rigorous, regulated and transparent governance structure.

Obviously, not all indices are, by their nature, able to meet all of the desired indicators, nor need all be regulated, but the more that can be met, the more reliable the index is likely to be.

While survey-based indices, such as LIBOR, have to date, been based on subjective answers, one of the key findings of the recent Wheatley Review is that LIBOR submissions should be explicitly and transparently supported by transaction data, where this is available. We would support such an approach more generally.

Q4: What measures should Submitters implement to ensure the integrity of information provided to Administrators? Are these measures adequately reflected in the discussion of a code of conduct for Submitters discussed in section E? In particular, should Submitters submit all input data and not a selection of such data so as to maximise the representation of the underlying market? Please comment on any practical issues that compliance with such an approach may give rise to.

We support the introduction of a code of conduct for submitters.

Data submitted to the Administrators should be sufficiently comprehensive to allow confidence in the reliability and accuracy of the index produced. While all data would be ideal we recognise that there are situations and markets where this may not be possible.

Q5: What level of granularity with regard to the transparency of Methodologies would enable users to assess the credibility, representativeness, relevance and suitability of a Benchmark on an on-going basis and its limitations with respect to their intended use? Relevant factors could include; criteria and procedures used to develop the Methodology, type of data used, how data is collected, relative weighting of data used, how and when judgement is used, contingency measures (e.g. methods when transaction data is unavailable etc.), publication of

information supporting each Benchmark determination, etc. Please provide examples where you consider there are currently significant gaps in the provision of this information.

Sufficient information about the methodology used should be provided to subscribers to the index to enable them to reproduce it from the data.

Q6: What steps should an Administrator take to disclose to Market Participants and other stakeholders the contingency measures it intends to use in conditions of market disruption, illiquidity or other stresses?

These details should be freely available, with the Methodology criteria, process and policies, ideally on the website of the Administrator, but at a minimum to all subscribers to the index.

Q7: What steps should an Administrator take to notify Market Participants of material changes to a Benchmark Methodology (including to Benchmark components) and to take their feedback into account?

There is a significant difference between changes to the methodology used to produce the index, and rebalancing of the composition. Indeed, it is important that the methodology sets out clearly the criteria and process for such rebalancings.

Administrators should give stakeholders, including the users of the index, at least sufficient prior notice to any change of methodology, and ideally they should discuss such changes with stakeholders prior to final decisions being taken. They should notify stakeholders of any rebalancing of the composition of the index.

Q8: How often should the Administrator review the design and definition of the Benchmark to ensure that it remains representative?

This should be done as necessary, depending on the nature of the index, the market on which it is based and any external influences which may arise.

Q9: The Consultation Report discusses a number of potential conflicts of interest that may arise at the level of the Submitters, between Submitters at different entities, and between Submitters, Administrators and other third parties. Are there other types of conflicts of interest that have not been mentioned that you consider may arise? If so, how best should these conflicts of interest be addressed? Are the measures discussed in the

Consultation Report sufficient to address potential conflicts of interests at the level of the Submitters, between Submitters at different entities, and between Submitters, Administrators and other third parties?

While it is difficult to be specific about the conflicts that arise, as the situation of each index is different, there should be a positive obligation on each Administrator to identify, manage and disclose the conflicts and potential conflicts particular to its operation.

It might be useful if all Administrators were required to make public:

- a description, which may be in summary form, of their conflicts of interest policy;
- when a material interest or conflict of interest may or does arise, the manner in which the firm will ensure fair treatment of the client;
- at any time that a relevant stakeholder requests it, further details of the conflicts of interest policy.

Q10: Do you agree that the Administrator should establish an oversight committee or other body to provide independent scrutiny of all relevant activities and management of conflicts of interest? Please comment if and why any different approaches might be appropriate for different kinds of Benchmarks. What is the minimum level of independent representation this committee or body should include?

All Administrators that are intentionally providing an index for commercial use as such by third parties should have some form of independent oversight committee. The size, nature and obligations of this should be proportionate to the nature of and risks inherent in the nature of the index that they produce.

Q11: Should the Submitters establish accountability procedures to assess their compliance with operational standards and scrutiny of Benchmark submissions?

Yes.

Q12: Are the measures discussed in the Consultation Report (e.g. Audit Trail, external audits and requirement for regulatory cooperation) sufficient to ensure the accountability of Submitters? Should additional mechanisms be considered?

Index submission should be, to some extent, a regulated activity, subject to authorisation and supervision by an appropriate competent authority. This should be proportionate to the nature of the index to which they are submitting data. The more

subjective the nature of the information to be provided the more necessary that it is subject to supervision.

However, even proportionally applied regulation would impose additional costs, initially on data submitters and Administrators but which would end up being passed on to end users in the form of increased charges for use of the index etc.

Q13: How frequently should Submitters be subject to audits? Should these be internal or external audits?

While we have no comment to make on the absolute frequency with which audits are carried out, the frequency should be appropriate to the specific index. The important feature is that the frequency and reasoning behind this is published as part of the index methodology so that all subscribers are able to assess, for themselves, whether the chosen frequency is appropriate.

Q14: Are the measures discussed in the Consultation Report (e.g., complaints process, Audit Trail, external audits and requirement for regulatory cooperation) sufficient to ensure accountability of the Administrator? Should additional mechanisms be considered?

Administration should be, to some extent, a regulated activity, subject to authorisation and supervision by an appropriate competent authority. The degree to which regulation is imposed on administrators should be proportionate to size, nature and subjectivity of the index.

For example, a commercial Administrator providing a subjective, submissions-based, index in order to earn money through subscribers paying to use it, present a higher regulatory risk, so should be more subject to regulation and supervision than a body that provides information about a financial sector 'universe' on a non-commercial basis.

Potential conflicts of interests should be taken into account where groups are both providers or and users of indices.

Q15: If recommended, how frequently should Administrators be subject to audits? Should these be internal or external audits?

While we have no comment to make on the absolute frequency with which audits are carried out, the frequency should be appropriate to the specific index. The important feature is that the frequency and reasoning behind this, ideally tied in to the internal control environment of the administrator, are published as part of the index methodology so that all subscribers are able to assess, for themselves, whether the chosen frequency is appropriate.

Q16: Is public self-certification of compliance with industry standards or an industry code another useful measure to support accountability? This approach might also contemplate explanation of why compliance may not have occurred. If so, what self-certification requirements would make this approach most reliable and useful to support market integrity.

While self-certification is better than nothing, external audit and regulatory supervision would give considerably greater confidence in the on-going reliability of an index.

Q17: The Consultation Report discusses elements of a code of conduct for Submitters. Are the measures discussed (e.g., adequate policies to verify submissions, record management policies that allow the Submitter to evidence how a particular submission was given, etc.) sufficient to address potential conflicts of interest identified or do you believe that other control framework principles should be added?

The proposals seem reasonable and adequate.

Q18: What would be the key differences in the code of conduct for Benchmarks based on different input types, for example transactions, committed quotes and/or expert judgement?

The greater the scope for judgement, discretion or subjectivity by the submitter or Administrator, the stricter should be the controls over this process.

Chapter 3: Discussion of options for enhanced oversight of Benchmark activities

Q19: What are the advantages and disadvantages of making Benchmark submissions a regulated activity?

Doing so may give those who use or rely on the index more confidence in its reliability.

However, even proportionally applied regulation would impose additional costs, initially on data submitters and Administrators but which would end up being passed on to end users in the form of increased charges for use of the index etc.

Q20: What are the advantages and disadvantages of making Benchmark Administration a regulated activity?

Doing so would impose extra costs on the Administrator, both directly in terms of regulatory fees and indirectly, in terms of work they would need to do to meet the imposed standards. Even proportionally applied regulation would impose additional costs, initially on data submitters and Administrators but which would end up being passed on to end users in the form of increased charges for use of the index etc.

Proper, effective supervision of an Administrator would give those who use or rely on their output more confidence in its reliability.

Q21: Do you agree with the factors identified for drawing regulatory distinctions? What other factors should be considered in determining the appropriate degree of oversight of Benchmark activities (discussed in Chapter 3)? Please provide specific recommendations as to how the distinctions discussed in Chapter 3 should inform oversight mechanisms.

We agree that some degree of distinction should be drawn between different types of index.

One risk we perceive is in the scope for those bodies which provide information on the financial services industry to, inadvertently, become Administrators, solely due to the action of third parties, choosing to use the information provided for one of those purposes set out in part c) of the definition.

Information providers of this sort should be able, in some way, to defend themselves from the possibility that third parties could use their information in a way which was not intended and impose, as a consequence, considerable onerous and expensive burdens on them.

It may be that a distinction could be drawn between Administrators who design and produce indices in order to be used as in pricing financial instruments, and those whose data is taken, without their knowledge or permission in order to do so.

Q22: What distinctions, if any, should be made with regard to Benchmarks created by third parties and those created by regulated exchanges?

We see no need for any qualitative or quantitative distinction between these two groups of indices.

Q23: Assuming that some form of enhanced regulatory oversight will be

applied to an asset class Benchmark, should such enhanced oversight be applied to the Submitters of data as well as the Administrator?

This should be decided on a case by case basis.

Q24: What are the considerations that should be taken into account if the Submitters to a Benchmark operate in an otherwise unregulated market (e.g., physical oil, gold or agricultural commodity markets) and are not otherwise under any obligation to submit data to an Administrator?

No comment.

Q25: Do you believe that a code of conduct, either on its own or in conjunction with other measures outlined within the report, would provide sufficient oversight to mitigate the risks that have been identified in Chapter 2? What measures should be established in conjunction with a code of conduct? For which Benchmarks is this approach suitable?

While a code of conduct is useful, it may not be adequate in all situations. Should the regulatory distinctions be applied then the Administrator of lower risk indices could comply simply with a code of conduct, with Administrators of higher risk indices subject to regulatory oversight.

Q26: What other measures outlined in the report, if any, should apply in addition to a code of conduct? If you believe a code of conduct, either on its own or in conjunction with other measures outlined within the report, would provide sufficient oversight to mitigate the risks that have been identified in Chapter 2, what type of code of conduct should apply (e.g., a voluntary code of conduct, an industry code of conduct submitted to and approved by the relevant Regulatory Authority, a code of conduct developed by IOSCO, etc.)?

Such codes should be applied proportionately on submitters and administrators. We feel that they would be most appropriate for indices based on subjective submissions.

Q27: Do you believe that the creation of a Self-Regulatory Organisation (e.g., one that exercises delegated governmental powers) and itself subject to governmental oversight, whether or not in conjunction with industry codes is a viable alternative for sufficient oversight and

enforcement to mitigate the risks that have been identified in Chapter 2? For which Benchmarks is this approach suitable? What if any complementary arrangements might be necessary, such as new statutory obligations or offences for Administrators and/or Submitters?

No

Q28: Do you believe that, for some Benchmarks, reliance upon the power of securities and derivatives regulators to evaluate products that reference a Benchmark or exercise their market abuse or false reporting powers creates sufficient incentives for the Administrator to ensure sure that Submitters comply with a code of conduct?

No.

Q29: Do you believe that users of a Benchmark, specifically, the users who are regulated or under the supervision of a national competent authority should have a role in enhancing the quality of Benchmarks? Which form should this role take: on a voluntary basis (e.g. the user being issued a statement that will only use Benchmarks that follow IOSCO principles), or on a compulsory basis (e.g., the competent authority could request that users who are registered under their jurisdiction should only use Benchmarks that fulfil IOSCO principles)?

We would be opposed to any compulsion on regulated users of indices. It is, obviously, up to them to determine the most appropriate index for the funds or services that they provide.

Users may be the first to identify problems with the indices that they are using. A method of notifying those responsible for them should be set up, so that any concerns can be directed to the appropriate body.

Chapter 4: Discussion of data sufficiency and transition

Q30: Do you agree that a Benchmark should be anchored by observable transactions entered into at arm's length between buyers and sellers in order for it to function as a credible indicator of prices, rates or index values? How should Benchmarks that are otherwise anchored by bona-fide transactions deal with periods of illiquidity due to market stress or long-term disruption?

Benchmarks should, where possible, be anchored by observable transactions. Trades eligible for this purpose should be only those that meet a narrowly defined set of transactions, consistent with the index.

Unfortunately this could make it easy for submitting firms to carry out any necessary transactions on such terms that they would not be reportable, if they wished to skew their submission in some way. There would also need to be controls to identify or prevent firms conducting trades away from true market prices, in order to corroborate a false submission.

Q31: Are there specific Benchmarks for which you consider that observable transactional data is not an appropriate criterion or the sole criterion? If so, please provide a description of such Benchmarks and what value you think such Benchmarks provide?

No comment.

Q32: What do you consider the limitations or value in Benchmarks referencing asset classes and underlying interests where there is limited liquidity? Please describe the uses and value of such Benchmarks in the financial markets.

While any permanent loss of liquidity in a market should lead to a re-evaluation of the index methodology, a temporary loss of liquidity can be dealt with by the administrators using a range of techniques, as long as these are clearly disclosed to the index users, so that they can assess the reliability of the index in such conditions.

Techniques used in temporary loss of liquidity situations could include estimates, calculations and extrapolations based on the best information available to the administrators. It is important that administrators make sufficient effort to provide the best prices or values possible in the circumstances, as users will value these over stale prices.

In such circumstances it is likely that there will be an on-going dialogue between the Administrators and subscribers to the index, so that users are able to assess the reliability of the index over such a period.

Q33: Do you agree that the greatest weight should be given to transactions in the construction of a Benchmark and that non-transactional information should be used as an adjunct (e.g. as a supplement) to transactions?

Given the range of different indices no absolute response can be made to this. It will depend, to a degree, on the nature of the index.

Q34: What factors and how often should Administrators (or others) consider in determining whether the market for a current Benchmark's underlying interest is no longer sufficiently robust? What effective methods of review could aid in determining the insufficiency of trading activity within the market for a Benchmark's underlying interest?

No comment.

Q35: What precautions by Benchmark Administrators, Submitters, and users can aid Benchmark resiliency during periods of market stress, mitigating the potential need for market transition?

No comment.

Q36: What elements of a Benchmark "living will," drafted by a Benchmark Administrator, should be prioritised?

We do not think that it should be for a regulator, or other body, to mandate index transition. Providing that there is adequate transparency and information from the Administrator it should be up to the users of indices to decide whether the index is still appropriate for their needs, or whether they should consider using some other index.

Q37: By what process, and in consultation with what bodies, should alternatives be determined for Benchmark replacement?

No comment.

Q38: What characteristics should be considered when determining an appropriate alternate Benchmark? (Examples below) Should any of these factors be prioritised?

- **Level and Type of Market Activity**
- **Diversity/Number of Benchmark Submitters**
- **Length of historical price series for the Benchmark alternative**
- **Benchmark Methodology**
- **Existing regulatory oversight**
- **Existing enforcement authority**
- **Volume, tenors and contract structure of the legacy trades**

It should be up to the users of an index to determine which alternative they would use, should they lose confidence in the index that they are using. The factors that they will consider will depend on the type of index that they have been using, the purpose for which they have been using it and the nature of the alternatives.

Q39: What conditions are necessary to ensure a smooth transition between market Benchmarks?

No comment.

Q40: What considerations should be made for legacy contracts which reference a Benchmark in transition? To what extent does a substantive legacy book preclude transition away from a Benchmark? What provisions can be included in [new and existing] contract specifications which would mitigate concerns if and when a Benchmark transitions occurs?

No comment.

Q41: How should a timeframe be determined for market movement between a Benchmark and its replacement? What considerations should be made for:

- **Altered regulatory oversight?**
- **Infrastructure development/modification?**
- **Revisions to currently established contracts referencing the previous Benchmark?**
- **Revisions to the Benchmark Administrator?**
- **Risk to contract frustration**

No comment.