

11 February 2013

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

Re: Public Comment on Financial Benchmarks

Dear Mr. Eroglu,

CFA Institute appreciates the opportunity to respond to IOSCO's consultation report on financial benchmarks (the "Consultation").

CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion for ethical behaviour in investment markets and a respected source of knowledge in the global financial community. The end goal: to create an environment where investors' interests come first, markets function at their best, and economies grow. CFA Institute has more than 110,000 members in 139 countries and territories, including 100,000 Chartered Financial Analyst® charterholders, and 136 member societies.

To inform regulatory reform initiatives associated with financial market benchmarks, CFA Institute surveyed its global membership on issues associated with the alleged manipulation of the London Interbank Offered Rate (LIBOR).¹ The survey addressed issues such as the methodology for the setting of LIBOR, the governance and supervision of LIBOR, and possible alternatives to LIBOR. Amongst other findings, the survey results indicated that a majority of CFA Institute members favour calculation methodologies based on actual transaction rates, regulatory oversight of interest rate benchmarks, and powers for regulators to pursue criminal sanctions in cases of manipulation of such benchmarks.

Executive Summary

CFA Institute believes that greater transparency over the calculation and production of benchmarks and indices in general, particularly where indices are based on subjective or judgmental inputs, is a key element to uphold integrity. Greater transparency underscores market discipline and helps mitigate conflicts of interest. Actual transaction data should be used in the compilation of benchmarks (where relevant) to the fullest extent possible.

Other important measures to ensure the integrity of benchmarks include robust internal controls, policies, and procedures surrounding the assimilation and contribution of data for the calculation of benchmarks; adequate management reporting and supervision over the provision of inputs; policies to manage and mitigate conflicts of interest; and appropriate regulatory oversight.

¹ The survey is available at http://www.cfainstitute.org/Survey/libor_survey_report_final.pdf

We believe that benchmark administrators and submitters should adhere to a code of conduct to ensure accountability. Codes of conduct should be supplemented by additional regulatory oversight of submitters or administrators or both, where relevant and as appropriate, along with strong enforcement powers. In general, benchmarks that are systemically relevant (i.e. are widely used or followed among different stakeholders or across markets or countries), that are based on subjective inputs (i.e. non-transaction data), and that are not adequately covered under existing financial market regulations (such as trade reporting and market abuse regulations under existing securities and derivatives markets legislation), should be the main candidates for additional regulatory oversight.

In general, the appropriate combination of industry codes and formal regulatory oversight and enforcement powers would help mitigate the risks and vulnerabilities associated with benchmarks.

We believe that regulators should limit themselves to the regulation of index production (where appropriate as outlined above) and not step into invasive regulation of index choice or limit index use.

Our specific comments in response to the Consultation's questions follow. For further information on the use of benchmarks in investment management, regulators and other interested stakeholders may wish to refer to the book "Benchmarks and Investment Management" published by the Research Foundation of CFA Institute.²

Please do not hesitate to contact us should you wish further elaboration of the points raised.

Yours faithfully,



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² Laurence B. Siegel, 2003, "Benchmarks and Investment Management", Research Foundation of CFA Institute, August 2003, Vol. 2003, No. 1, available at <http://www.cfapubs.org/toc/rf/2003/2003/1>

Specific Comments

CFA Institute is a not-for-profit professional association that represents the interests of investment professionals. We have responded to those questions that are relevant to our organisation.

Chapter 1: Introduction

- 1. 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.**

We agree with the scope of this report, which examines risks to the credibility of benchmarks and risks to users arising from issues associated with the methodology, transparency, and governance of financial benchmarks. We consider the scope of benchmarks reviewed by IOSCO to inform its work, which includes indices based on interest rate borrowing markets, repo markets, swap markets, equity, credit, commodity, and currency markets, as well as alternative investments, to be sufficiently broad.

Chapter 2: Discussion of Potential Issues

- 2. Do you agree that the design of a Benchmark should clearly reflect the key characteristics of the underlying interest it seeks to measure?**

We agree. For a benchmark to be credible and useful to investors, it must fairly and accurately represent the key attributes of the market segment or financial instrument in question.

In particular, benchmarks should be investable, measurable, (with some frequency for performance attribution), appropriate, reflective of current investment opinions, specified in advance (publicly known at the start of an evaluation period where possible), and owned (i.e. there is appropriate accountability).

- 3. What measures should Administrators take to ensure the integrity of information used in Benchmark-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, and discretion exercised by Administrators. Are these measures adequately reflected in the discussion of roles and responsibilities of the Administrator discussed in section E?**

To ensure the integrity of information and that the data are bona fide, administrators should establish and enforce a code of conduct over data submissions that unambiguously and transparently specifies the basis and process for inputting data. Administrators should also ensure that the composition of the panel or set of inputs used to calculate the benchmark is a fair and accurate representation of the underlying interest being measured. The selection of panels, index contributors, or constituents should be based on clear, objective, and robust criteria and governed by the relevant industry committee or body responsible for administering the benchmark in question. Panel members should be sufficiently numerous, diverse and sufficiently active to accurately and fairly represent the market in question.

Furthermore, administrators should perform adequate quality assurance procedures to verify or corroborate data submissions. For example, for survey-based (i.e. non-transaction) data, administrators should assess the reasonableness of submissions having regard to other gauges of relevant financial market activity (e.g. comparing purchasing managers indices with GDP data; comparing interest rate benchmarks such as LIBOR with overnight index swaps (OIS) and the spread between such measures having regard to historical norms or averages; comparing benchmark expectations derived from models or formulas with actual outcomes). Administrators should seek clarification and understanding over data outliers. Periodic audits or third-party verification over the information produced by administrators would also help to strengthen the integrity of benchmark-setting.

The factors identified in the Consultation regarding the vulnerability of data inputs include voluntary submission and continuity of participation (i.e. the willingness to participate on an ongoing basis). These vulnerabilities can create sample selection biases, such as survivorship bias which commonly can exist among hedge fund indices (unsuccessful funds cease trading, leaving only the most successful funds in the index). LIBOR, given its relatively small panel sizes and voluntary contributions, is another example of a benchmark subject to sample bias. In that case, increasing the panel size would be advantageous. The weight attached to any single contribution ($1/n$) in the panel is lower the higher the number of participants (the higher is n); therefore, in large panels, the absence of a few voluntary contributions would be less likely to influence the outcome. We also acknowledge the Wheatley Review recommendations to give the regulator reserve powers to compel contributions to LIBOR, which would also help mitigate the aforementioned vulnerabilities.

Other vulnerabilities discussed in the Consultation include benchmarks where administrators exercise discretion over index composition or the rebalancing of constituents, and the size and composition of a panel and its representativeness of the underlying market. We concur with these vulnerabilities and have no further comments beyond those expressed above.

Section E of the Consultation discusses the elements of a code of conduct for submitters that could be established by administrators. Our comments with respect to section E are set out in questions 17 and 18. To address the vulnerabilities identified above, any such code should also include periodic review of the composition of the benchmark to ensure that it accurately and fairly represents the key characteristics of the underlying interest. Alterations to the composition of the benchmark should be based on transparent policies.

- 4. 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.**

Submitters should provide all relevant data to administrators. To ensure the integrity of information provided to administrators, the following arrangements are necessary among submitters: high levels of transparency over the provision of inputs, including over the basis of inputs; robust internal controls, policies, and procedures; adequate management reporting and supervision over the provision of inputs; policies to manage and mitigate conflicts of interest; and in the case of systemically important benchmarks based on subjective inputs (such as LIBOR), appropriate regulatory oversight of the submissions process.

The suggested elements of a code of conduct for submitters as outlined in section E of the Consultation should, in addition to the aforementioned measures, also reference adequate management reporting over the submissions process to ensure accountability.

- 5. 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.**

Producers of benchmarks should provide sufficient transparency for users to be able to clearly understand and evaluate the methodology used to compile the benchmark. All of the factors listed in the question are informative and should be made available to investors and other benchmark users to help them assess the benchmark's applicability or suitability.

As the Consultation notes (section B.1), transparency of methodology is especially important when benchmark inputs comprise non-transaction based data, either in part or whole. In our view, indices that do not use actual transaction data are generally less robust. However, depending on the type of index or benchmark in question, use of transaction data alone can be disadvantageous if actual transaction data are not always current, timely, or readily available. In these cases, use of transaction data alone may result in the production of an index that is stale or not reflective of fair market value.

Therefore, a tiered approach that places emphasis in the first instance on actual transaction data, supported by estimated data where current transaction data are not available, can be advantageous. An analogous approach is prescribed under accounting standards for the determination of fair value of a financial instrument. Generally, fair value is taken to be the current market price of a security or financial instrument. However, where a current market price is not available, fair value may be determined by using a model, formula, or methodology that uses observable inputs. If neither approach is possible, fair value may be determined using a model, formula, or methodology using unobservable inputs. This three-tiered approach could be applied generally to various indices.

It is important to note, however, that the more reliance that is placed on models, formulas or judgment, the greater the transparency that is needed (of both the inputs into the models or formulas and of the models or formulas themselves) in order to protect the integrity of the benchmark and to mitigate conflicts of interest.

- 6. 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?**

Benchmark producers should clearly disclose their policies and circumstances for using alternative inputs when current transaction-based data are unavailable. The information should include specific criteria for when alternative inputs would be used and ideally the length of time for which it would be permissible to produce the benchmark based on these alternative inputs. These policies and circumstances should be specified in advance of index production and updated as necessary.

It is important, however, that the exercise of discretion in these circumstances is kept to a minimum and only used when current transaction data are unavailable, such as during episodes of market stress or illiquidity. During such times, investors should be provided with even greater transparency in order to uphold confidence and to enable liquidity to return. In periods of market stress, opacity regarding the production of benchmarks and financial instruments in general merely breeds uncertainty and exacerbates stress.

7. 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?

We agree with section B.3 of the Consultation, which notes that administrators should consult with relevant stakeholders prior to a change in methodology. We also agree that for benchmarks that require periodic rebalancing, users would benefit from advance information on the methodology used for rebalancing in order to assess the continued suitability of the benchmark.

Administrators should make all relevant information on benchmark methodology freely available to users through a website.

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

We are not able to suggest a specific review timeframe, but believe that reviews should take place any time there is a material change to the market or underlying interest that the benchmark seeks to represent (such as a prolonged discontinuity in benchmark participants or index contributors, or a prolonged period of illiquidity that would prevent transaction-based data from being used where transaction data are otherwise the norm, etc.)

9. 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?

The conflicts of interest discussed in the consultation include private economic incentives among submitters (different divisions within the same entity) to engage in manipulative practices and incentives between submitters (among different entities) to manipulate a benchmark in a collusive fashion, as well as possible conflicts between market participants and administrators, particularly where the administrator is a trade body representing participants or is owned by market participants. We concur with these conflicts and have no comments on any other conflicts of interest.

In general, measures to address potential conflicts of interest should include: effective controls; Chinese walls; continuously evaluating and using effective methodologies for submissions or data inputs; management and supervision of relevant personnel along with a credible whistle-blowing policy and complaints procedure; appropriate reporting and cooperation with relevant authorities; monitoring, reviews and audits of submissions processes; appropriate documentation and record-keeping; appropriate transparency through reporting to the public, to the market, and to

authorities; and possible regulation of the activity of submitting an input into the production of a benchmark, where appropriate (such as rate submissions to LIBOR).

The points raised in sections C, D, and E of chapter 2 of the Consultation adequately cover the aforementioned measures.

- 10. Do you agree that the Administrator’s oversight committee or other body could 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. For example, where Administrators simultaneously act as the trade body for Submitters to the Benchmark. What is the minimum level of independent representation this committee or body should include?**

We agree that the administrator’s oversight committee should play an active role in scrutinising all issues related to integrity of the benchmark. However, in cases where the administrator is a trade body representing the interests of the contributors to the benchmark, and where the benchmark is systemically important and calculated based on non-transaction data, an oversight committee alone may be insufficient to protect the integrity of the benchmark. In such cases, an oversight committee of the administrator may not be a sufficiently credible deterrent to prevent abusive or manipulative practices on the part of contributors.

This scenario has been most notably evident in the case of the LIBOR scandal. Given the systemic importance of the LIBOR benchmark, its reliance on subjective inputs, and the manifest failures in its governance arrangements, public supervision by the relevant regulatory authority is a necessary component of the oversight framework, in addition to any private oversight committees established by the administrator.

With regard to the representation of an oversight committee, there should be an appropriate balance between sufficient oversight independence and sufficient knowledge of the business issues associated with production of the index concerned. Best practice would be to aim for at least an equal number of executive and independent members with the appropriate expertise.

- 11. Should the Submitters establish accountability procedures to assess their compliance with operational standards and scrutiny of Benchmark submissions?**

Yes, we agree that submitters should adopt procedures to ensure appropriate accountability for their benchmark submissions.

- 12. 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 the Submitters? Should additional mechanisms be considered?**

Adopting adequate documentation requirements and keeping records for a sufficient length of time are necessary accountability measures to enable supervisors and auditors to perform their respective duties. In addition to the measures identified in the question, submitters should also have in place adequate complaints procedures and whistle-blowing mechanisms.

Together, these measures are sufficient for submitters, however the measures discussed in the Consultation only focus on the accountability of administrators.

- 13. How frequently should Submitters be subject to audits? Should these be internal or external audits?**

Submitters should be subject to annual audits. Submitters should accept at least internal audits. These measures could be adequately prescribed in a code of conduct and need not necessarily be mandated by statute.

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

Yes, the measures discussed in the Consultation and listed in the question are sufficient to ensure accountability of administrators.

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

Administrators should be subject to annual audits. Best practice would be for administrators to accept internal and external audits of their business. These measures could be adequately prescribed in a code of conduct and need not necessarily be mandated by statute.

16. 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?

We support compliance among benchmark administrators and submitters with an industry code of conduct; we also support self-certification of compliance with industry standards prescribed by such a code.

One analogous example is the calculation and presentation of composite performance data by investment firms that adhere to the Global Investment Performance Standards (GIPS®).³ The GIPS standards are produced and maintained by CFA Institute. Firms that present their composite performance in accordance with the GIPS standards are recommended to have their performance information verified by a third party and are required to include a statement indicating whether or not the firm was verified in their GIPS compliant presentations. The GIPS standards are globally accepted, widely used, and recognised as the gold standard in investment performance reporting.

Self-certification of compliance with industry codes could therefore be accompanied by a statement indicating whether the compliance has been verified by a third party.

17. 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 control framework principles to address conflicts of interest are appropriate. The Consultation sufficiently addresses measures to mitigate conflicts of interest in sections C, D, and E of chapter 2 (see response to question 9). These measures should be appropriately reflected in the code of conduct principles.

³ Visit <http://www.gipsstandards.org/Pages/index.aspx>

18. 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?

Any code of conduct for benchmarks should specify principles that are extensible to all types of financial benchmarks. This would ensure broad applicability and sufficient flexibility for the code to apply to new benchmarks developed over time.

Chapter 3: Discussion of Options for Enhanced Oversight of Benchmark Activities

19. What are the advantages and disadvantages of making Benchmark submissions a regulated activity?

Regulation of benchmark submissions can be advantageous by acting as a credible deterrent to abusive or manipulative practices on the part of submitters. The threat of enforcement and sanctions provides a stronger incentive to contribute accurate and fair submissions than industry oversight alone. For enforcement to be credible, it must be backed up by strong statutes. Authorities must be endowed with powers to impose fines in the case of fraudulent activity (such as deliberate mis-reporting of a benchmark submission for private economic gain) that are commensurate with the scale of the fraud committed. Regulators should also possess criminal sanctioning powers to punish manipulative or abusive practices for interest rate benchmarks such as LIBOR; such powers have been hitherto lacking.

However, for benchmarks that are based purely on transaction-based data, additional regulation of benchmark submissions might not yield marginal benefits if the market transactions concerned are already covered under existing securities or derivatives markets legislation, such as regulation that prescribes trade reporting practices and regulation that prohibits market abuse. In these cases, additional regulation of submitters over and above regulation prohibiting abusive transactions (for example) would likely impose unnecessary costs.

Regulation of benchmark submissions should therefore be focused in the first instance on benchmarks that are systemically important and that are based on non-transaction (i.e. subjective) data.

One such example is LIBOR. In a recent survey, 70% of CFA Institute members globally and 77% in EMEA (Europe, Middle East and Africa) supported regulatory oversight of the LIBOR submission process. In the same survey, 82% of respondents agreed that regulators should possess powers to pursue criminal sanctions over LIBOR manipulation. Such oversight would act as a credible deterrent to manipulation and would provide authorities with appropriate powers to pursue sanctions against perpetrators.

20. What are the advantages and disadvantages of making Benchmark Administration a regulated activity?

The advantages of regulating benchmark administration include the threat of regulatory enforcement action acting as a mechanism to ensure sufficiently robust administrative processes, controls and governance, and the mitigation of conflicts of interest which can arise when the

administrator is a trade body or is owned by the market participants who submit data to the administrator.

The main disadvantage is the imposition of regulatory cost which may be unnecessary if the benchmark is produced by a well-governed private entity not subject to the aforementioned conflicts of interest, and where the benchmark is based on transaction (i.e. objective) data.

In the case of LIBOR, a majority of CFA Institute members (55%) thought that LIBOR should be administered and overseen by industry bodies but subject to regulatory oversight. Only 11% of members thought that administration and oversight by industry bodies alone was sufficient.

21. 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.

The factors identified in the Consultation with regard to drawing regulatory distinctions include: distinctions based on the economic impact of the benchmark (whether it is broadly or internationally used or whether it has a narrower relevance); distinctions based on a general failure in benchmark provision; distinctions based on whether the benchmark is referenced in exchange traded derivatives, securities, or products (whether existing securities or derivatives markets legislation provides authorities with jurisdiction over financial instruments based on benchmarks); and distinctions based on the regulatory status of submitters, administrators and/or the interest measured by the benchmark.

We agree with these factors. In addition, the type of data used to compile the benchmark (i.e. transaction-based or non-transaction based) is another factor that could inform the decision of whether to impose regulatory oversight or not. In general, benchmarks that are systemically relevant (i.e. are widely used or followed among different stakeholders or across markets or countries), that are based on subjective inputs, and that are not adequately covered under existing financial market regulations, should be the main candidates for additional regulatory oversight.

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

We have no specific comments, though we agree with the Consultation (section B.4) that benchmarks designed and administered by regulated exchanges that are based on daily transparent transaction data and that are calculated according to fixed and transparent formulas raise fewer integrity issues than other types of benchmarks.

23. 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?

Please refer to our responses to questions 19 and 20 on the factors related to regulatory oversight of submitters and administrators, respectively. We have no further comments.

24. 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?

As noted in question 21, the absence of existing financial market regulations over the products or actors in a given market is an important factor informing the determination of when or where additional regulatory oversight is appropriate. We have no further comments.

25. 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?

We believe that a code of conduct, supplemented by additional regulatory oversight of submitters or administrators or both, where relevant and as appropriate (such as when the factors elaborated in our response to questions 19, 20, and 21 apply), along with strong enforcement powers, would be sufficient to mitigate the risks and vulnerabilities associated with benchmarks.

26. 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.)?

We have no further comments on other measures. With regard to a code of conduct, all of the aforementioned codes may be suitable. However, an industry code submitted to the relevant authority, and a code that conforms to general principles established by IOSCO (to be incorporated into the individual codes of conduct for administrators and/or submitters), generally are more advantageous.

In our CFA Institute member survey on LIBOR, 89% of respondents agreed that a global framework of key principles or best practices should be developed for internationally used benchmarks. A code of conduct developed by IOSCO could help to further this aim.

27. 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?

CFA Institute historically has supported self-regulation in lieu of government-imposed regulation. Where self-regulation is practiced, best practice would be for the SRO body to be separate and distinct from the market or operations it oversees, in order to strengthen independence and mitigate conflicts of interest.⁴

Our support for self-regulation, however, is tempered in situations where investor protections appear to be compromised. In cases where the benchmark is systemically important and manifestly deficient, as in the case of interest rate benchmarks such as LIBOR, self-regulation alone is not the best option to mitigate the risks identified regarding benchmark integrity.

⁴ See CFA Institute's report on self-regulation in securities markets at <http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2007.n7.4819> .

In the case of systemically important interest rate benchmarks such as LIBOR, formal regulatory oversight over administrators and the submissions process is appropriate, in addition to adherence to self-regulatory codes of conduct. Please refer to our responses to questions 19, 20 and 21 as to when formal regulatory oversight is appropriate in addition to industry measures. In the case of LIBOR and other similar measures, formal regulatory oversight is therefore preferable to self-regulation alone.

28. 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?

As noted in our response to question 19, where benchmarks are based purely on transaction-based data, additional regulation of benchmark submissions might not yield marginal benefits if the market transactions concerned are already covered under existing securities or derivatives markets legislation, such as regulation that prescribes trade reporting practices and regulation that prohibits market abuse.

Where regulators have sufficient jurisdiction over financial instruments based on benchmarks, administrators and submitters are more likely to take the requisite care to ensure compliance with their obligations.

29. 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)?

In general, we believe that regulators should limit themselves to the regulation of index production (where appropriate) and not step into invasive regulation of index choice or limit index use.

We believe that if benchmark producers comply with a code of conduct and certify their compliance, investors would likely choose those benchmarks over other comparable benchmarks that do not comply with a code.

Benchmark producers should therefore view compliance with a code of conduct as a competitive strength that is valued by users.

Chapter 4: Discussion of Data Sufficiency and Transition

30. 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?

We agree that a benchmark should be anchored by observable transactions entered into at arm's length between buyers and sellers. As the Consultation notes (p.40), "The discipline of observable

transactions, providing they are of a bona-fide nature, should give a level of confidence that the price discovery system is accurate. Moreover... expert judgements (extrapolating values from related transactions) may increase the potential for manipulation or for an “outlier” trade to corrupt the benchmark values.” We concur with these sentiments.

However, depending on the type of index or benchmark in question, use of transaction data alone can be disadvantageous if actual transaction data are not always current, timely, or readily available, such as during periods of illiquidity or acute market stress. In these cases, use of transaction data alone may result in the production of an index that is stale or not reflective of fair market value. Therefore, a tiered approach that places emphasis in the first instance on actual transaction data, supported by estimated data where current transaction data are not available, can be advantageous. Please refer to our response to question 5 for further detail.

As we have noted in question 6, benchmark producers should clearly disclose their policies and circumstances for using alternative inputs when current transaction-based data are unavailable. During times of market stress, investors should be provided with even greater transparency in order to uphold confidence and to enable liquidity to return. In periods of market stress, opacity regarding the production of benchmarks and financial instruments in general merely breeds uncertainty and exacerbates stress.

31. 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?

We are only able to comment on LIBOR and related interest rate benchmarks. CFA Institute members believe that actual transaction rates are the most appropriate basis for calculation of interest rate benchmarks. 56% of CFA Institute members responding to a survey on LIBOR said that the most appropriate methodology for the setting of LIBOR would be an average rate based on actual inter-bank transactions only; a further 32% thought that a hybrid methodology using actual and estimated rates would be appropriate.

In summary, we believe that actual rates should be used wherever possible but in certain circumstances (such as when the inter-bank market is very illiquid), estimated rates could play a part in the setting of interest rate benchmarks. Actual transaction data should therefore be used to the fullest extent possible, supported by subjective data where transaction data are not current, timely, or readily available.

32. 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.

Such benchmarks do carry some use for investors, albeit limited. An example is an index or benchmark based on real estate values, which may be illiquid if underlying transactions are infrequent or if independent valuations are not current or simply not conducted. Despite these limitations, the benchmark provides users with some estimate or reference point on which to base their expectations or measure performance.

33. 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?

We agree. Please refer to our responses to questions 5 and 30.

34. 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?

As noted in our response to question 8, reviews should take place any time there is a material change to the market or underlying interest that the benchmark seeks to represent, such as a prolonged discontinuity in benchmark participants or index contributors, or a prolonged period of illiquidity that would prevent transaction-based data from being used where transaction data are otherwise the norm, etc.

The sufficiency of trading activity should be compared relative to historical norms or averages for the market in question, and compared relative to activity in similar markets or financial instruments. Various indicators of liquidity (such as the breadth of participants, the depth of trading interest, the level of the bid-offer spread, the variability of prices, etc.) should be considered when making such comparisons.

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

The most important factor is to ensure sufficient transparency around benchmark production during periods of market stress, including policies and circumstances specified in advance that indicate how production of the benchmark will be impacted by market conditions, and what those conditions might be.

As we have noted in previous questions, during times of market stress, investors should be provided with even greater transparency in order to uphold confidence and to enable liquidity to return. In periods of market stress, opacity regarding the production of benchmarks and financial instruments in general merely breeds uncertainty and exacerbates stress, thereby threatening the continued viability of the benchmark.

36. What elements of a Benchmark “living will,” drafted by a Benchmark Administrator, should be prioritised?

The Consultation discusses in detail a number of factors related to the development of living wills for benchmarks, such as modifications to benchmark methodology or inputs, as well as benchmark cessation and transitional issues. These are appropriate considerations and we have no further comments.

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

All benchmark users and other interested market participants should be consulted prior to any transition from one benchmark to another. Regulators and administrators should formally consult interested stakeholders and engage in discussion with key users.

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

- o Level and Type of Market Activity
- o Diversity/Number of Benchmark Submitters
- o Length of historical price series for the Benchmark alternative

- o **Benchmark Methodology**
- o **Existing regulatory oversight**
- o **Existing enforcement authority**
- o **Volume, tenors and contract structure of the legacy trades**

All of these factors are important considerations. However, the length of the historical price series for the benchmark alternative is of lower importance. New benchmarks should not be disregarded as viable alternatives to incumbent benchmarks if they measure substantively the same underlying interest but have little time series by virtue of being new.

Generally, the most important factor for determining the substitutability of a benchmark is the extent to which an alternative benchmark measures or represents a similar underlying economic interest.

39. What conditions are necessary to ensure a smooth transition between market Benchmarks?

No further comments beyond those cited in the Consultation.

40. What considerations should be made for legacy contracts that 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 that would mitigate concerns if and when a Benchmark transitions occurs?

We are not able to comment on legal provisions or contract specifications related to legacy issues. A substantial legacy book is a significant obstacle to transition away from a benchmark in the short-term, but need not be prohibitive if the transition is carefully managed over an appropriate length of time.

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

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

We are not able to comment on these specific considerations.

With regard to LIBOR, 47% of CFA Institute members surveyed thought that an alternative to LIBOR could be introduced within 1 year, while 26% thought that an alternative could be introduced within 3 years but not within a year.