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December 3, 2012

ICI and ICI Global Comment Letter to European Commission on the Regulation of Indices

[26738]

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TO: ICI GLOBAL STEERING COMMITTEE No. 12-12
ICI GLOBAL EXCHANGE TRADED FUNDS COMMITTEE No. 3-12
SEC RULES COMMITTEE No. 79-12
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 42-12
ETF ADVISORY COMMITTEE No. 48-12
INTERNATIONAL COMMITTEE No. 48-12
ICI GLOBAL MEMBERS RE: ICI AND ICI GLOBAL COMMENT LETTER TO EUROPEAN COMMISSION ON THE REGULATION OF INDICES

The European Commission recently released a consultation paper (the "Consultation") on the regulation of indices, subtitled "A Possible Framework for the Regulation of the Production and Use of Indices serving as Benchmarks in Financial and other Contracts." * The Consultation seeks to "identify the key issues and shortcomings in production and use of benchmarks in order to assess the need for any necessary changes to the legal framework…." To that end, it requests stakeholder input on a series of specific questions on the production, use, and calculation of indices, among others.

ICI and ICI Global submitted the attached joint comment letter, focusing on the use of indices by asset managers. It urges the Commission to carefully distinguish such uses, which it terms uses "other than as a benchmark," as it considers potential regulation of indices and benchmarks, and to narrowly tailor any regulation to address its underlying concerns.

The letter begins by explaining that asset managers use indices for two primary purposes: as a method of evaluating an active manager's performance, e.g., to demonstrate how well such a manager performs in selecting securities relative to a benchmark, and as a target for passive managers to track in managing an index fund. The letter states that while not immune, indices that are used for either of these purposes are far less conducive to manipulation than benchmarks used to price financial contracts.

The letter explains that because indices used by asset managers are typically provided by a commercial index provider, there is little opportunity for an asset manager – or anyone else that might have an interest – to manipulate such indices. The data underlying securities indices is typically taken from a regulated exchange or other source of market bids, offers, or executed prices. With respect to aspects of an index's composition that are more subjective, decisions are made in the sole discretion of the index provider, pursuant to a published methodology. The letter explains that even when index providers are affiliated with funds that track their indices, laws governing the funds specifically address the potential for conflicts of interest.

The letter further explains that commercial providers of indices used by asset managers have every incentive to prevent such manipulation, because they do not have a direct interest in the value of the index, but they do have a strong interest in creating indices that are known to be robust and accurate; a loss of faith in the integrity of an index would cause serious commercial damage to the provider.

Finally, the letter suggests that, due to the global nature of indices and benchmarks, any approach to regulation of indices should be undertaken globally. It notes that the International Organization of Securities Commissions ("IOSCO") recently formed a Board Level Task Force on Financial Market Benchmarks to consider many of the same issues described in the Consultation, and urges the Commission to engage with that initiative as it continues its consideration of the regulation of benchmarks and indices.

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Attachment

endnotes

[*] The Consultation is available at http://ec.europa.eu/internal_market/consultations/docs/2012/benchmarks/consultation-document_en.pdf.