

**MEMO# 27001**

February 12, 2013

# ICI and ICI Global Submit Comments to IOSCO on Financial Benchmarks

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TO: ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 11-13  
ETF ADVISORY COMMITTEE No. 11-13  
ICI GLOBAL EXCHANGE TRADED FUNDS COMMITTEE No. 3-13  
ICI GLOBAL MEMBERS  
INTERNATIONAL MEMBERS No. 11-13  
SEC RULES MEMBERS No. 22-13 RE: ICI AND ICI GLOBAL SUBMIT COMMENTS TO IOSCO ON FINANCIAL BENCHMARKS

The International Organization of Securities Commissions (“IOSCO”) recently published a “Consultation Report on Financial Benchmarks” (the “Consultation”). [\[1\]](#) ICI and ICI Global submitted a joint letter in response, which is attached and briefly summarized below.

## Background

The Consultation clearly has roots in recent events that have eroded confidence in the credibility of LIBOR and similar survey-based benchmarks. Based on concerns over the fragility of certain benchmarks, like LIBOR, IOSCO constituted a board-level task force to articulate policy guidance and principles for benchmark-related activities. To inform this work, the Consultation identifies a wide range of concerns over benchmark methodology, transparency, governance, and accountability, as well as the role and responsibilities of benchmark administrators.

## Principal Comment on the Regulation of Benchmarks

The theme of ICI and ICI Global’s letter is that one size does not fit all when it comes to the regulation of benchmarks, and that IOSCO can and should draw distinctions between survey-based benchmarks, such as LIBOR, and other types of benchmarks, such as commercial indices licensed by regulated funds. The letter commends IOSCO for identifying a number of serious concerns with respect to survey-based benchmarks, but cautions IOSCO against expanding that review without first identifying specific, tangible concerns that warrant regulatory intervention.

## Comments on Specific Parts of the Consultation

The letter addresses five areas of the Consultation: 1) its scope; 2) benchmark

methodology; 3) benchmark transparency; 4) benchmark governance; and 5) drawing distinctions among benchmarks.

Scope of the Consultation. The letter supports IOSCO's efforts to reform the process for establishing LIBOR and other survey-based benchmarks, but characterizes the scope of the Consultation as "overly broad," noting that it is far broader than just survey-based benchmarks. [2] It explains that commercial indices do not share the characteristics that underlie the erosion of confidence in LIBOR, and argues that as a result, any attempt to develop of a single set of regulatory principles to address the entire diverse universe of benchmarks and commercial indices would be ill advised.

Benchmark Methodology. In this section of the letter, we address IOSCO's concerns over benchmark methodologies. As a preliminary matter, we highlight the fact that a regulated fund that licenses and tracks a commercial index is subject to a variety of requirements designed to ensure that the index is suitable for that purpose and that fund investors have the information necessary to evaluate the fund and index. We also point out that commercial interests provide strong incentives for robust index methodologies.

We then argue that IOSCO's concerns over things such as the quality and vulnerability of data inputs, administrator discretion, the composition of submitting panels, and calculation options—while valid with respect to survey-based benchmarks such as LIBOR—are simply not relevant to the production of commercial indices used by asset managers. In this regard, the letter argues that for commercial indices, the data is more robust, administrators have less discretion, interested parties have no meaningful opportunity to influence, and administrators have every incentive to prevent manipulation.

Benchmark Transparency. The letter continues its themes in response to IOSCO's questions about benchmark transparency, recommending that IOSCO draw distinctions between survey-based benchmarks and commercial indices and focus on the appropriate role of regulation in achieving the desired level of transparency. The letter argues that the information provided by commercial index administrators allows the licensing asset manager to assess the credibility, representativeness, relevance, and suitability of a benchmark on an ongoing basis, and that as a result, we do not believe additional regulation is necessary to achieve that result. The letter takes issue with the Consultation's suggestion that the same level of transparency be made public, arguing that it is unnecessary and would have significant negative consequences by enabling front running, free riding, and increased costs.

Benchmark governance. Chapter 2C of the Consultation sets forth concerns over potential conflicts of interest that may arise in the benchmark setting process. The letter agrees with IOSCO that conflicts may arise, but again urges it to take care in distinguishing the nature and types of conflicts that may arise with survey-based benchmarks, such as LIBOR, from those that may arise in the context of commercial indices. Ultimately, while the letter acknowledges that the potential for conflicts of interest clearly is an appropriate area for securities regulators to evaluate, it expresses our belief that this Consultation has not identified a sufficient basis for concern with respect to the potential for conflicts of interest in commercially provided securities indices.

Drawing Regulatory Distinctions among Benchmarks. Consistent with the overarching theme in the letter, we recommend that IOSCO draw an initial distinction among benchmarks based upon the documented failures in the governance and controls around survey-based benchmarks, rather than attempting to distinguish benchmarks based on

their economic impact or the regulated status of any market participant.

## **Conclusion—the Costs of Unnecessary Regulation**

The letter concludes by pointing out that the imposition on market indices of unnecessary regulations is not just an issue for index administrators, but also for regulated funds that license the use of their indices and ultimately, their investors. It argues that regulation has the potential to increase costs and raise barriers to entry in the index administration business, each to the detriment of index licensees and ultimately fund investors.

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### [Attachment](#)

#### **endnotes**

[1] The Board of the International Organization of Securities Commissions, Consultation Report CR01/03 on Financial Benchmarks, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD399.pdf>.

[2] Exhibit 1 of the Consultation makes it clear that IOSCO contemplates recommendations that would apply not only to benchmarks such as LIBOR, but also to exchange-traded products that track indices, such as ETFs.

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