Financial Benchmarks Regulatory Reform

A Consultation Paper by the

Council of Financial Regulators

March 2016

Council of Financial Regulators

Consultation Process

Request for feedback and comments

This Consultation Paper seeks stakeholder views on proposed regulatory reforms to financial benchmarks.

Submissions should include the name of your organisation (or your name if the submission is made as an individual) and contact details for the submission, including an email address and contact telephone number where available.

While submissions may be lodged electronically or by post, electronic lodgement is strongly preferred. For accessibility reasons, please email responses in a Word or RTF format. An additional PDF version may also be submitted.

All information (including name and contact details) contained in submissions will be made available to the public on the CFR website, unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information clearly marked as such in a separate attachment. Any future request made under the *Freedom of Information Act 1982* for a submission marked 'confidential' to be made available will be determined in accordance with that Act.

Closing date for submissions: **Friday 29 April 2016**

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1 Introduction

The Council of Financial Regulators (**CFR**) is seeking views on options to reform the regulation of financial benchmarks.

Financial benchmarks (benchmarks) are indices or indicators used as reference prices for financial instruments or contracts, or to measure the performance of investment funds.

Benchmarks are of critical importance to a wide range of users in financial markets and throughout the broader economy. Benchmarks affect the pricing of key financial products such as credit facilities offered by financial institutions, corporate debt securities, exchange-traded funds (**ETFs**), foreign exchange (**FX**) and interest rate derivatives, commodity derivatives, equity and bond index futures and other investments and risk management products. They also drive or influence asset allocation decisions within investment portfolios.

Poor conduct in relation to benchmarks can mean that a benchmark does not accurately reflect the underlying interest it measures. Such conduct can inflict losses on clients of financial institutions and, if benchmarks are seen to be open to abuse, market confidence may be affected.

Concerns about the reliability and robustness of financial benchmarks have led to a number of reforms, domestically and internationally. In July 2015, in its Report 440 *Financial Benchmarks* (**Report 440**), the Australian Securities and Investments Commission (**ASIC**) foreshadowed that further domestic regulatory reforms may be needed to address benchmark conduct issues.

The CFR believes that there is a clear need for reform to ensure continued confidence in Australia's financial markets' architecture. Consequently, the CFR seeks feedback from interested stakeholders on a number of regulatory reform options. The reforms proposed by the CFR have three aspects:

(a) **benchmark administration:** making administration of a significant benchmark a financially regulated activity and imposing obligations on the administrator of a significant benchmark that are consistent with the IOSCO Principles for Financial Benchmarks[1] of July 2013 (**the IOSCO Principles)**[2], including audit, governance and conflicts management requirements;

(b) **benchmark submission**: imposing binding requirements, consistent with the IOSCO Principles, on submitters to a significant benchmark calculated based on submissions, and creating a legal power to compel submission to a significant benchmark; and

[1] IOSCO Board, *Principles for Financial Benchmarks*, July 2013, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf.
[2] A summary of the IOSCO Principles forms **Appendix A** to this paper.

(c) **benchmark misconduct:** introducing a new specific offence of benchmark manipulation applicable to all financial benchmarks. Separately, expressly expanding the scope of financial products to bank accepted bills (**BABs**) and negotiable certificates of deposit (**NCDs**).

These three aspects of reform would be mutually reinforcing and would most fully mitigate the relevant risks if all three were to be progressed.

The reform options advanced in this consultation paper are guided by the IOSCO Principles and by the recommendations of the Financial Stability Board (**FSB**) with regards to FX benchmarks and interest rate benchmarks.[3] They are also informed by reforms proposed or implemented in key foreign jurisdictions, notably, the United Kingdom (**UK**), the European Union (**EU**), Japan, Singapore, Hong Kong and Canada.

2 Problem identification and regulatory objective

Without regulatory reform there is an appreciable risk of:

(a) impaired financial investor trust and confidence in the integrity of key financial benchmarks referenced in AUD-denominated products; and

(b) reduced international acceptance of, or participation in, key AUD-denominated financial benchmarks and the financial products that reference them, leading to less efficient financing of our economy.

The first risk has also been identified at the global level by the FSB, which has expressed concern that the scale of misconduct in some financial institutions has risen to a level that undermines trust in financial institutions and markets.[4]

The second risk arises in part because of the extra-territorial impacts of, most notably, the EU's proposed benchmarks regulation. The EU regulation will require EU-based financial institutions to only use benchmarks that comply with EU regulation or otherwise comply with the regulation's third-country benchmark recognition regime. Similarly, Japan's benchmarks regime has an extra-territorial component.

The design of any regulatory reform will be guided by the overarching regulatory objective of strengthening market integrity with regards to financial benchmarks, while preserving or enhancing market access and participation.

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[3] FSB, *Reforming Major Interest Rate Benchmarks,* July 2014, available at http://www.financialstabilityboard.org/2014/07/r_140722/ and *Foreign Exchange Benchmarks: Final Report,* September 2014, available at http://www.financialstabilityboard.org/2014/09/r_140930/

[4] Letter from Chairman, FSB to G20 Finance Ministers and Central Bank Governors dated 4 February 2015

The regulatory objective for each element of reform is identified below.

3 Scope of coverage

Australian authorities must determine which class of financial benchmarks should be brought within scope of regulatory reforms. There are two salient options: cover all financial benchmarks, or cover significant benchmarks only.

The CFR is minded to advise Government that any new offence of benchmark manipulation should extend to all financial benchmarks so as to promote market integrity across all benchmarks. This would align with the position under the EU's market abuse regulation and the offences proposed in both Canada and Singapore.

However, in respect of the proposed benchmark administration and benchmark submission reforms, the CFR considers that only significant financial benchmarks should be subjected to regulation for the following reasons:

(a) covering all financial benchmarks is arguably not a proportionate response to the problems that have been observed, which have largely been focused on important, widely-used benchmarks including the IBOR family of interest rate benchmarks and the key FX benchmarks; and

(b) imposing the administration and submission regulatory requirements on all financial benchmarks would be a resource-intensive and costly exercise both for regulators and the regulated community.

3.1 Significant benchmarks

The CFR considers that a benchmark is significant if it is systemically important. That is, there is a material risk of financial contagion or systemic instability if the availability or integrity of the benchmark is disrupted. Other factors that may be relevant to the significance of a benchmark include the materiality of the impact on retail or wholesale investors if the availability or integrity of the benchmark is disrupted.

Using comparable criteria, ASIC stated in Report 440 that the potentially systemically important financial benchmarks administered by the private sector in Australia are:

(a) the Bank Bill Swap Rate (**BBSW**), administered by the Australian Financial Markets Association (**AFMA**);

(b) the Commonwealth Government Securities (**CGS**) yields survey for settling bond futures administered by ASX Clear (Futures) Pty Ltd; and

(c) the S&P/ASX 200 equity index administered by S&P Dow Jones Indices LLC (**SPDJI**).

The CFR is minded to advise Government that the BBSW and the CGS yields survey are significant benchmarks, for which administration and submission should be brought within scope of regulation.

However, the CFR considers that the S&P/ASX 200 equity index may not currently need to be brought within the scope of administration and submission regulation because it is an equity benchmark calculated from regulated data. Regulating such an index may go beyond the scope of comparable regulation internationally.

Questions

1. Do you have any comment on the proposed definition and scope of significant financial benchmarks?
2. Do you have a view on whether major equity indices such as the ASX200 should be subject to regulation as significant benchmarks?
3. Are there any other financial benchmarks that you consider should be subject to regulation as significant benchmarks?

3.2 Officially administered benchmarks

There are two further benchmarks which were mentioned in Report 440 as of potential systemic importance: the cash rate administered by the Reserve Bank of Australia (**RBA**) and the Consumer Price Index (**CPI**) administered by the Australian Bureau of Statistics (**ABS**).

The CFR considers that administration of the cash rate and the CPI should be excluded from any new regulatory regime of benchmark administration and submission. This is in accordance with the IOSCO Principles, which exclude benchmark administration by a national authority used for public policy purposes from scope.

In any event these benchmarks are, or will shortly be, subject to tailored oversight arrangements:

(a) The RBA plans to issue a voluntary self-assessment of the cash rate against the IOSCO Principles in 2016.

(b) The CPI is governed by the *Consumer Price Index Manual: Theory and Practice* (authored by the IMF, OECD, UN, World Bank, Eurostat and the ILO) and the IMF's Special Data Dissemination Standard.

3.3 How to designate which benchmarks are within scope of regulation

There are three options to designate regulated benchmarks. These are:

(a) **List-only option**: list significant benchmarks in a Regulation. The list could then be amended as needed from time to time by Government;

(b) **Criteria-only option**: set out criteria for determining that a benchmark is significant in a Regulation. The criteria would then be applied by ASIC (in consultation with the other CFR agencies) to determine which benchmarks are significant and hence come within scope; or

(c) A **hybrid option**: significant benchmarks would be listed in a Regulation, and ASIC (in consultation with the other CFR agencies) would have the ability to add further benchmarks by determination. The Regulation would state criteria by which ASIC (in consultation with the other CFR agencies) would assess any further benchmarks for inclusion.

A hybrid model is already used to prescribe trade repositories, and has recently been adopted to prescribe central counterparties for mandatory clearing purposes as well.

The CFR considers that the hybrid option offers a suitable balance between the regulatory certainty provided by a list in a Regulation, and the flexibility the regulator needs to adapt to changing circumstances. For this reason, the CFR is minded to recommend the hybrid option to Government.

The criteria embodied in the Regulation could be amplified with further explanation of the intended scope in a policy document adopted by Government (such as an Explanatory Statement) to provide certainty to stakeholders.

Questions

4. Do you have any comment on the proposed mechanism for designating the scope of regulation?

3.4 Scope of regulation in overseas reforms

When the UK regulation was first introduced in 2013 the only specified benchmark was the London Interbank Offered Rate (**LIBOR**). Subsequently in 2014 the Chancellor asked the Fair and Effective Markets Review to recommend additional benchmarks that should be brought into the regulatory framework. In response, criteria were developed and published in a report to HM Treasury.[5] Through the application of these criteria, an additional seven benchmarks were identified as 'specified benchmarks' and an amending regulation came into force in April 2015 containing the updated list of specified benchmarks.

In the UK, only benchmarks which are 'major' benchmarks in Fixed Income, Currencies and Commodities (**FICC**) markets have been brought within the scope of the UK regulatory regime. In judging whether a benchmark is 'major', the FEMR considered that the relevant indicators include the number and value of financial contracts directly or indirectly linked to the benchmark, the range of ways in which the benchmark is used, and the degree of market recognition. The rationale was that benchmarks that meet those indicators would have the biggest impact on retail and wholesale investors if they were distorted or abused, and would represent the greatest source of systemic vulnerability and risk if their integrity were questioned.

The FEMR also determined to target only those benchmarks which are based directly on instruments that are outside the scope of the existing market misconduct regime, or which have indirect dependencies on instruments outside the scope of the market abuse regime where additional mechanisms may be needed to monitor potential sources of abuse.

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[5] HM Treasury, Bank of England, FCA, *Fair and Effective Markets Review: Recommendations on additional financial benchmarks to be brought into UK regulatory scope,* report, August 2014, available at: http://www.bankofengland.co.uk/markets/Documents/femraug2014.pdf

By contrast, the proposed EU Regulation on financial benchmarks[6] will apply to all published benchmarks regardless of the method of calculation or the nature of the contributions. From this starting point of universal coverage, 'critical' benchmarks[7] may then attract further regulation, whilst benchmarks whose input data is provided by regulated venues will be released from certain obligations in order to avoid dual regulation.

4 Benchmark administration

4.1 Regulatory objective

Given the global nature of trading on financial markets (including over the counter (**OTC**) derivatives and FX markets) and the global applicability of the IOSCO Principles, the CFR does not seek to develop an 'Australian-tailored' set of benchmark administration requirements.

Therefore, the objective of any regulatory reforms with regards to benchmark administration should be to ensure that administrators are subject to a binding framework which effectively embeds compliance with the IOSCO Principles as requirements of domestic law. This would support the overall regulatory objective.

In terms of the content of the requirements, the CFR would seek to ensure any requirements can be applied in a way that is appropriate for each significant benchmark, and can also adapt to future developments, including technological developments. As part of the regime, the administrator could be required to:

(a) comply with the IOSCO Principles;

(b) conduct a regular self-assessment (for example, annually) against the IOSCO Principles and publish it, in line with the existing recommendation in Report 440; and

(c) commission a regular (for example, two-yearly) independent audit review of IOSCO compliance, provide it to ASIC, and publish it (or at least make available to users on request).[8]

[6] Proposal for a Regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts. The final compromise text is available at http://data.consilium.europa.eu/doc/document/ST-14985-2015-INIT/en/pdf.

[7] In the proposed EU regulation, critical benchmarks can be determined using a quantitative criterion or a combination of quantitative and qualitative criteria. The precise criteria and mechanisms for determining critical benchmarks are set out in Article 13.

[8] This requirement would align with the EU regime for direct recognition of third-country benchmark administrators by the European Securities Markets Authority (**ESMA**), which applies in the absence of an

4.2 Options for imposing the IOSCO Principles on benchmark administrators

Licensing option

One way to apply the IOSCO Principles to benchmark administrators would be to make administration of a significant benchmark a financial service under the *Corporations Act 2001* (**Corporations Act**). This could be done via a Regulation under s766A(1)(f).

If benchmark administration becomes a financial service, benchmark administrators would have to obtain an Australian financial services licence (**AFSL**) unless they hold a clearing and settlement (**CS**) facility licence or a financial markets licence and if the calculation of the benchmark is incidental to the operation of the CS facility or financial market.

Under this option the IOSCO Principles would be embedded in the licence conditions. Some of the IOSCO Principles may need to be reworded to make them legally certain before they could be used.

This approach is modelled to some extent on how ASIC has implemented the IOSCO principles for credit rating agencies (**CRAs**). In 2010, ASIC revoked class order relief to require CRAs to obtain an AFSL for the first time, with the relevant IOSCO principles imposed on CRAs via AFSL conditions.

This is the option preferred by the CFR.

ASIC rulemaking power

Another way to impose the IOSCO Principles on administrators of significant benchmarks would be to provide ASIC with a rulemaking power.

Such a power could be similar to ASIC's rulemaking powers in Part 7.2A and Part 7.5A of the Corporations Act to make market integrity rules and derivative trade repository rules, respectively.

ASIC rules made under such a power could, for example, require compliance with the IOSCO Principles and publication of an independent audit review of compliance every two years.

Such a power may be able to be conferred by a modifying Regulation under s798L, extending the scope of the Market Integrity Rule writing power set out in s798G(1) (both of the Corporations Act). Alternatively, primary legislation could confer a special-purpose power.

Questions

5. Which means of imposing the IOSCO Principles as a requirement of benchmark administration would you favour among the options identified, and why?

"equivalence decision" (ie a binding EU legal act finding that an administrator's home country regulatory regime is equivalent to the EU regulatory regime): see Article 21a.

6. Is there another option you prefer?

4.3 Overseas reforms to regulate benchmark administration

As mentioned in section 3.4, in the UK the administration of LIBOR was brought within the scope of financial regulation under the *Financial Services and Markets Act 2000* (UK) in 2013. In April 2015, as part of the Fair and Effective Markets Review, seven additional benchmarks were brought into this regulatory framework including the WM/Reuters London 4pm Closing Spot Rate (an FX benchmark). The Financial Conduct Authority (**FCA**) supplemented these changes by introducing Chapter 8 of the FCA Handbook Market Conduct (MAR 8), which contains rules and guidance for benchmark administrators.

The European Commission, the European Parliament and the Council of the EU have reached preliminary agreement to introduce a new Regulation on financial benchmarks. The proposed Regulation, which remains subject to a vote by the European Parliament, would make benchmark administration a regulated activity, improve governance systems and standards to reduce benchmark vulnerability to manipulation and abuse, enhance transparency and maintain supply and access to a wide variety of benchmarks.

Draft legislation under consideration in Canada would allow the proposed Capital Markets Regulatory Authority to designate a benchmark as 'systemically important' if impairment to its reliability or a loss of public confidence in its integrity or credibility could pose a systemic risk to capital markets. Regulations can prescribe requirements relating to the administration of a benchmark designated as 'systemically important'.

Similar changes have also been made in Japan and are proposed in Singapore.

5 Benchmark submitters

We note that the BBSW, the CGS yields survey, and the S&P/ASX200 are currently calculated according to methodologies that do not use submissions.

However, the CFR has undertaken a separate public consultation on the evolution of the BBSW methodology and it is possible that BBSW could move to a submission-based methodology at some stage, either to supplement platform-based pricing information or as a fall-back mechanism.

More generally, clearly it is possible that over time significant benchmarks may migrate or revert to submissions-based methodologies in response to market evolutions.

Given this, the CFR considers that the regulatory framework should address both transactions-based and submissions-based methodologies.

5.1 Regulation of benchmark submitters

5.1.1 Regulatory objective

The primary objective of the proposed regulatory reform would be to ensure that submitters[9] to significant benchmarks are subject to requirements equivalent to the Submitter Code of Conduct prescribed by Principle 14 of the IOSCO Principles, so as to support the overall regulatory objective identified above.

Principle 14 requires benchmark administrators to:

(a) develop, and then subject submitters to, a Submitter Code of Conduct (**Code**) addressing a number of specified issues;[10]

(b) only use submissions from entities which adhere to the Code;

(c) appropriately monitor and record adherence from submitters; and

(d) be responsible for the continuing review and oversight of the Code.

For reasons discussed in section 3 of this paper, the CFR considers that the scope of a regulatory regime requiring benchmark submitters to comply with IOSCO Principle 14 should be limited to significant benchmarks.

5.1.2 Options to regulate benchmark submission

Indirect regulation via benchmark administrators

Submitters could be indirectly regulated via requirements imposed on the benchmark administrator as part of their compliance with the IOSCO Principles.

As part of a benchmark administrator's regulatory requirements, the benchmark administrator could be required to lodge a copy of their Code and of the record of submitter adherence with ASIC.

A principal advantage of indirect regulation is that benchmark submitters would be subject to clearly defined expectations without the need to introduce any changes beyond the reforms targeted at benchmark administrators. It would also allow each benchmark administrator to develop a Code for that benchmark.

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[9] IOSCO defines submitters as “A legal person providing information to an Administrator or Calculation Agent required in connection with the determination of a Benchmark.” This would appear to be a suitable definition for these purposes.

[10] Principle 14 sets out that the Code should address: the selection of inputs; who may submit; criteria applied to employees of a submitter who are permitted to submit; policies to discourage the interim withdrawal of submitters; policies to encourage submitters to submit all relevant data; and the submitters' internal systems and controls.

One potential concern, however, is that under this approach the onus would be on the benchmark administrator to appropriately develop and then enforce the Code. ASIC itself would have no power to take action against a submitter for a breach of the Code, unless the breach was also a breach of their obligations under the Corporations Act or other applicable legislation such as the *Australian Securities and Investments Commission Act 1998* (ASIC Act).

Direct regulation via AFSL regime

Benchmark submitters could be regulated directly by amending the Corporations Act to make submission to a significant benchmark a financial service. This would require submitters to hold an AFSL or qualify for an exemption. As a condition of the AFSL or any exemption, the submitter could be required to comply with a Code for any significant benchmarks that were relevant.

This option may present complexities:

(a) Varying the AFSL conditions of a large number of submitters to impose the submission condition would be administratively complex and could open up undesirable differences in treatment between similarly placed firms.

(b) There could also be complex questions around the application of existing class orders for foreign financial services providers (**FFSP**), which depend on there being substantially equivalent home regulatory regimes in place.

(c) In order to avoid difficulties associated with a delegation of power to a private body, such a condition may need to refer to a particular administrator's Code at a particular point in time and to be updated as and when each Code was updated. (Alternatively, it could refer to a generic Code of Conduct that could potentially be developed by ASIC itself. However, such a Code would be less tailored to each relevant benchmark.)

ASIC rulemaking power

A third option to regulate submitters would be to extend ASIC rulemaking powers (such as those contained in Part 7.2A or Part 7.5A of the Corporations Act) to cover submitters to a significant benchmark. The rulemaking power could be extended in the ways described at section 4.2 of this paper. The ASIC rules would then set out the terms otherwise proposed to be included in a Submitter Code of Conduct.

This option is potentially complex and would likely be slow to implement as it would require primary legislation and regulations.

However, compared with indirect regulation and imposing conditions on AFSL holders it has the benefit of imposing, with certainty, the same obligations on all submitters.

Self-regulatory option

ASIC has the ability to approve codes of conduct under section 1101A of the Corporations Act. Therefore, a fourth option would be for ASIC to approve a self-regulatory code of submitter conduct. Such codes are described in detail in ASIC Regulatory Guide 183: *Approval of financial services sector codes of conduct.*

However, no regulatory consequences result from ASIC having approved a code, and, to date, ASIC has not approved any codes under this section. For this reason the benefits to be gained from approval of such a code are limited (including benefits arising by reason of recognition of Australia's regulatory regime by foreign regulators).

This option could also be quite complex to implement, potentially requiring negotiations across a range of stakeholder groups that would be disparate across benchmarks.

Conclusion

The CFR considers that indirect regulation via administrators and the direct regulation (via AFSL or the ASIC rulemaking power of submitters) each have benefits and drawbacks.

The CFR encourages feedback on which option is to be preferred to assist it in formulating advice to Government.

In identifying a preferred option, the CFR will have regard to the feedback received on options to compel submission to a significant benchmark because regulatory reforms that apply to benchmark submitters should be developed and implemented in a cohesive manner.

Questions

7. Among the options presented, which option do you prefer for regulating benchmark submission, and why?
8. Do you consider that benchmark administrators would be able to effectively regulate submitters via a Submitter Code of Conduct?

5.1.3 Overseas reforms to regulate benchmark submission

Benchmark submission has been made a regulated activity alongside benchmark administration in the UK under the *Financial Services and Markets Act 2000* (UK), and MAR 8 contains rules and guidance for benchmark submitters in addition to those for benchmark administrators.

The European Commission has proposed, and Japan has adopted, indirect regulation on submitters (that is, requiring administrators to establish submitter codes of conduct). In addition, the European Commission's proposed regulation imposes further requirements on submitters that are supervised entities, such as credit institutions and investment firms.

In Hong Kong, the Monetary Authority has introduced a Code of Conduct for Benchmark Submitters pursuant to section 7(3) of the *Banking Ordinance* (HK). The code is a statutory guideline which sets out requirements for submitters on organisational and governance arrangements, conflicts of interest, retention of records, independent reviews, handling of complaints and whistleblower reports.

Singapore's proposed regulatory framework would also capture benchmark submitters and proposed legislation in Canada would allow for regulations to prescribe requirements, prohibitions or restrictions in relation to the submission of information for the purpose of determining systemically-important benchmarks.

5.2 Compelling submission to a benchmark

The CFR understands that some market participants may, in the absence of an obligation to submit, elect to withdraw from benchmark submission processes to reduce compliance risk. Cumulatively this may result in the dataset provided for a benchmark calculation becoming too sparse for the calculation of a benchmark which reliably reflects the underlying interest it is meant to measure.

The ability to compel submissions could future-proof the regulatory regime by allowing, at short notice, a benchmark to move to a submissions basis, or to use submissions as a fall-back for benchmark calculation.

5.2.1 Regulatory objective

A second reform objective could be to create a legal obligation for benchmark submitters to submit to a significant benchmark if required to ensure the robustness and availability of significant benchmarks.

The CFR envisages that it may be necessary for the reform to enable compulsion of pre-existing submitters to remain submitters and also to compel entities to become submitters.

5.2.2 Options to compel benchmark submission

Code of conduct or contractual options

Unlike the case for regulation of benchmark submitters generally, there is no scope to compel submissions through a Code imposed by the benchmark administrator as a condition of participation, or through a code of conduct that is approved by ASIC under s1101A. Both of these mechanisms are essentially voluntary in nature in so far as an entity can avoid the requirements of the code of conduct, including the requirement to submit, by withdrawing from being a submitter.

For similar reasons, it is expected that using contractual requirements to compel submission may be ineffective if, on balance, the submitting entity has no commercial incentive to maintain the relevant commercial relationship.

Impose an AFSL condition requiring submission

One way to compel submissions would be to impose conditions on submitter firms' AFSLs or FFSPs' class order exemptions to require them to submit to specified significant benchmarks. The use of licence conditions could give ASIC the flexibility to compel specific entities to submit to specific significant benchmarks, as appropriate.

However, varying the licence of a large number of submitters would be administratively complex and subject to individual administrative challenge. Similarly, varying applicable class orders would likely result in complex issues arising, as discussed above.

ASIC rulemaking power

Another option to compel submission would be to give ASIC a rulemaking power to impose an obligation on specified entities (the scope of which would need to be set out in the relevant legislation) to make submissions to specified significant benchmarks.

This would firstly require extending the remit of ASIC's rulemaking powers which would require primary legislation and potentially Regulations, as well as any relevant ASIC rules.

Within the universe of significant financial benchmarks, it would also be necessary for a body (presumably ASIC, on the basis of criteria set out in the legislation) to determine the specified benchmarks in respect of which submissions ought to be compelled. This could be specified in the ASIC rules, the Regulations or potentially another instrument type such as an ASIC determination.

The primary legislation would also need to carefully define the cohort of entities that could be made subject to such a power. It is suggested that any authorised deposit-taking institution (**ADI**), AFSL holder or FFSP could in principle be made subject to the rulemaking power.

Declaration linked to the prescription of a significant benchmark

Another option is to identify entities that are compelled to submit to each benchmark that is identified as significant. For example, when a benchmark is prescribed under Regulations or by ASIC as a significant benchmark, ASIC could also have the power to declare that certain entities (or a class of entities) would be compelled to submit to this benchmark.

This option would also give ASIC the flexibility to compel entities to submit to particular significant benchmarks as appropriate. More than the other options discussed, this option would raise the question of an appropriate penalties regime to enforce this proposed requirement.

Conclusion

The CFR considers there are merits in each of the direct regulation options, though each has advantages and disadvantages. The CFR will take into account the regulatory reforms that would apply to the regulation of benchmark submission, to ensure the requirements that may apply to benchmarks submitters are developed and applied in a coherent manner.

Depending on the preferred options identified for regulating and compelling benchmarks submissions, the CFR would also consider whether a specific penalties regime may be necessary.

Questions

9. Do you agree that it is appropriate to develop a reserve power to compel benchmarks submissions for significant benchmarks, including to official sector significant benchmarks?
10. If so, who should be able to exercise such a power?
11. Which option do you prefer for compelling submission, and why?
12. Do you have any comments on the suggested cohort of entities that could be made subject to such a power?
13. Do you have any other suggestions for how to compel submissions?

5.2.3 Overseas reforms to compel benchmark submission

In the EU, Article 14 of the proposed benchmarks regulation allows the relevant competent authorities to compel submissions to critical benchmarks in order to preserve the existence and credibility of the benchmark in question.

The administrator of a critical benchmark is required to submit, to the competent authority every two years, an assessment of the capability of the benchmark to measure the underlying market or economic reality. In addition, if a contributor to a critical benchmark intends to cease contributing, they must notify the administrator and the administrator must inform the competent authority. The administrator is then required to submit to the competent authority an assessment of the implications on the capability of the benchmark to measure the underlying market or economic reality.

If the competent authority considers, on the basis of its own assessments as well as the administrators assessments, that the representativeness of a critical benchmark is put at risk, it shall have the power to require supervised entities, including those which are not already contributors to the relevant critical benchmark, to contribute input data to the administrator in accordance with the methodology, code of conduct or other rules.

In the UK, the 2012 Wheatley review recommended that, the FCA be provided with a new rule-making power to require banks to submit to LIBOR and other appropriate benchmarks.[11] The Wheatley review outlined the importance of the banks continuing to play an active role in the process of submitting to LIBOR otherwise it could lack sufficient evidence to be an authoritative benchmark.

The power allows the FCA to impose requirements on authorised persons to participate in a benchmark, including by reference to any code or other document published by the person responsible for the setting of the benchmark, such as the benchmark administrator. This ensures that the precise detail of what information is required to be provided, the format, to whom and at what time can be determined by the administrator through their code, and not directly by the FCA.

6 Strengthening offences around benchmark manipulation

There are a number of provisions in the Corporations Act and the ASIC Act which potentially apply to benchmark-related misconduct, including provisions about:

(a) the obligations of Australian financial services licensees;

(b) market misconduct and other prohibited conduct relating to financial products and financial services;

(c) unconscionable conduct; and

(d) misleading or deceptive conduct.

[11] S.137F of the Financial Services and Markets Act 2000, inserted by the Financial Services Act 2012 (UK)

However, other key jurisdictions such as the EU, UK and Canada which likewise have general market misconduct provisions have also introduced or have proposed additional offences with specific application to benchmark misconduct.

The IOSCO Principles state that IOSCO Members should initiate action, appropriate to their jurisdiction's legal and regulatory structure, to adopt enforcement regulations that make manipulation and attempted manipulation of a benchmark an offence where such benchmark is referenced in a financial contract or financial instrument.

The CFR is accordingly considering whether Australia should introduce a specific offence for misconduct in relation to a benchmark.

To do so would place Australia in-step with responses by foreign jurisdictions, and may play a role in informing or framing equivalence decisions as to the effectiveness of benchmark administrator supervision and enforcement in Australia.

6.1 Overseas reforms to introduce benchmark manipulation offences

In the UK it is a criminal offence under the *Financial Services Act 2012* (UK), punishable by imprisonment of a maximum of seven years, to:

(a) make false or misleading statements in the course of arrangements for the setting of a relevant benchmark; or

(b) to do any act or course of conduct which creates a false or misleading impression as to price or value that may affect the setting of a relevant benchmark.

For the first limb, the statement must be made in or from the UK or to a person in the UK. For the second limb, the act must be done or course of conduct engaged in in the UK or the false or misleading impression created in the UK.

The same eight benchmarks[12] that have been declared 'specified benchmarks' for the purpose of benchmark administration regulation have also been declared relevant benchmarks for the purpose of the UK offence.

In the EU, Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse will enter into force in July 2016. Under the market abuse Regulation, market manipulation of benchmarks includes:

[12] The London Interbank Offered Rate (also known as LIBOR); ISDAFIX; Sterling Overnight Index Average (also known as SONIA); Repurchase Overnight Average (also known as RONIA); WM/Reuters London 4 p.m. Closing Spot Rate; London Gold Fixing; LBMA Silver Price; ICE Brent Index.

(a) transmitting false or misleading information or providing false or misleading inputs in relation to a benchmark where the person knew or ought to have known that it was false or misleading; or

(b) any other behaviour that manipulates the calculation of a benchmark.

Administrative sanctions listed in the market abuse Regulation include cease and desist orders, disgorgement of profits gained or losses avoided, a public warning, withdrawal or suspension of authorisation, temporary ban of a person with managerial responsibilities who is responsible for the infringement, and administrative pecuniary sanctions. Additionally, Directive 2014/57/EU on criminal sanctions for market abuse provides that the offence will be punishable by a maximum term of imprisonment of at least four years.

The draft *Capital Markets Act* in Canada creates two criminal offences relating to benchmarks punishable by a fine or by imprisonment for a term of not more than 5 years, or by both.

(a) The first proposed offence is engaging or participating, directly or indirectly, in the provision of information to another person for the purpose of determining a benchmark if the person knows or reasonably ought to know that the information, at the time and in the circumstances in which it is provided, is false or misleading. It would also be an offence to attempt to do so.

(b) The second proposed offence is engaging or participating, directly or indirectly, in conduct relating to a benchmark that improperly influences the determination of the benchmark or produces or contributes to the production of a false or misleading determination of the benchmark. It would also be an offence to attempt to do so.

The proposed reforms to the *Securities and Futures Act* in Singapore include the creation of new offences for financial benchmarks manipulation and for making false or misleading statements likely to affect any matters relating to the process of administering a financial benchmark. The offences would be punishable by a fine or by imprisonment not exceeding seven years, and would apply to acts occurring within Singapore in relation to financial benchmarks whether administered in Singapore or elsewhere, and to acts occurring outside Singapore in relation to financial benchmarks which are administered in Singapore.

6.2 Options for introducing new benchmark manipulation offences

6.2.1 Scope

If new benchmark manipulation offences are introduced in Australia, the first question is whether the offences will cover all financial benchmarks or cover significant benchmarks only.

The CFR considers that any new benchmark manipulation offence should extend to all financial benchmarks. This would work to promote market integrity across all benchmarks, rather than just significant benchmarks.

Although different from the UK approach, this would be consistent with the Canadian proposal and the comparable EU offence (contained within the market abuse regulation[13] due to come into force in 2016) which will apply to all published benchmarks.

6.2.2 Proposed offences

Following the examples from overseas, it is proposed that two new benchmark manipulation offences be introduced to criminalise the following types of behaviour:

(a) making false or misleading statements (including by providing false or misleading data) in connection with the determination of a benchmark; and

(b) engaging in dishonest conduct in relation to, or conduct that has or is likely to have the effect of creating or causing the creation of a false or misleading appearance with respect to trading (or the price for trading) in financial products that affects, the determination of the benchmark (whether alone or in combination with other conduct of the same kind, whether by the same or different persons). Such an offence would be comparable to the existing offences in s1041B and s1041G of the Corporations Act.

If new benchmark manipulation offences are introduced, it will be necessary to determine what the respective fault elements should be. It is suggested that the fault elements should follow the general principles of criminal liability set out in Chapter 2 of the Commonwealth Criminal Code, namely, the fault element for any physical element that consists of "conduct" should be "intention" and the fault element for any physical element that consists of "circumstance" or a "result" should be "knowledge"

The CFR is also minded to recommend to Government that as well as criminal liability for misconduct, legislation provide that any new benchmark manipulation offence provisions:

(a) be civil penalty provisions under s1317E of the Corporations Act; and

(b) attract civil liability under s1041I of the Corporations Act.

It is also necessary to determine the jurisdictional application of the offences. Reflecting the approach taken in other jurisdictions, the CFR considers that it may be necessary to draft the offence to have different jurisdictional reach according to whether or not the benchmark is administered in Australia.

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[13] Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse

(a) In respect of benchmarks administered in Australia, in order to have broad jurisdictional reach the offence and civil liability provisions could apply to the making of statements, and to conduct, whether in this jurisdiction or elsewhere. This is the approach taken in a number of the existing provisions of Part 7.10 of the Corporations Act such as s1041A (market manipulation) and s1041E (false or misleading statements).

(b) In respect of benchmarks not administered in Australia, the CFR is considering whether any offence and civil liability provisions could apply to the making of statements and to conduct that have the necessary connection to Australia. The connection could exist: :

i. where action is taken by an ADI, AFSL holder or a FFSP; or

ii. where the conduct has an impact on an AUD-denominated product; or

iii. where the conduct has an impact on an Australian market or Australian investors.

6.3 Treatment of BABs and NCDs

The CFR also considers there may be a separate case to expressly extend the scope of "financial products" for the purposes of Part 7.10 of the Corporations Act (which deals with market misconduct) to cover certain financial products such as BABs and NCDs. Doing so would reflect how the market operates in these products, and would ensure that the market manipulation provisions of the Corporations Act clearly apply to these products.

Given the potential benefit of enhanced market confidence and market integrity, the CFR is unlikely to support a no change option.

If the Government elected to extend the scope of "financial products" to include NCDs and BABs, consideration would need to be given to whether:

(a) any markets and clearing and settlement facilties that facilitate trading of BABs and NCDs or clear and settle such trades which are not licensed, need to be licensed under Part 7.2 and 7.3 (respectively) of the Corporations Act; and

(a) advisory, dealing and other activities with regards to BABs and NCDs should be considered as financial services for Chapter 7 purposes, so as to require a person providing such services on a professional basis in Australia to hold an AFSL or be exempt.

Questions

14. Do you have any comment on the proposal to introduce a specific offence of benchmark manipulation?
15. Do you agree that the proposed offence should cover all financial benchmarks rather than just significant benchmarks?
16. Do you have any comment on:
    a. the physical elements of the proposed offence,
    b. the fault elements of the proposed offence,
    c. the proposed civil liability provision; or
    d. the proposed jurisdictional reach of the proposed offence? Are there other factors that should be considered in defining the jurisdictional reach of the proposed

offence?

17. Do you have any comment on the separate proposal to expressly provide that BABs and NCDs are financial products for the purposes of Part 7.10 of the Corporations Act?
18. Do you have any other comments?

7 Benefits and costs of regulatory reform

7.1 Benefits

Regulatory reform in Australia along the lines suggested in this paper could be expected to bring about significant regulatory and market access benefits.

Reform could be expected to:

(a) strengthen the market integrity framework surrounding financial benchmarks in Australia, minimising the risk of conflicts of interest and poor governance impairing the robustness and reliability of significant benchmarks;

(b) protect Australia’s reputation as a financial centre and promote investor trust and confidence in benchmarks and financial institutions by aligning with applicable IOSCO principles and peer jurisdiction regulatory changes; and

(c) improve access to global financial markets for Australian benchmark administrators by making the Australian regime suitable for a finding of equivalence with foreign regimes.

7.2 Costs

The costs of regulatory reform would include compliance costs for benchmark administrators and potentially submitters, as well as government costs associated with administering the regime.

Any additional cost to benchmarks administrators or submitters created by the proposed regulatory reforms would be explored using the Government’s regulatory burden measurement framework.

Questions

19. Do you have any comments on the benefits and costs of reform?

Appendix A – Summary of the IOSCO Principles

Conduct issue	Details
Governance	The IOSCO Principles ensure that benchmark administrators: • have appropriate governance arrangements in place to address conflicts of interest and protect the integrity of the benchmark determination process; • retain primary responsibility for all aspects of that process; • maintain appropriate oversight of any third parties that undertake activities relating to that process; and • have a control framework and an internal oversight function to review and provide challenge on all aspects of benchmark determination.
Benchmark quality	The IOSCO Principles: • promote the quality and integrity of benchmark determinations through the application of design factors which result in a benchmark that reflects a credible market for the interest measured by that benchmark; • clarify that a variety of data may be used to construct a benchmark, as long as the data used is sufficient and based on an active market and there are clear protocols governing the hierarchy of data inputs and exercise of expert judgement; and • require the administrator to describe and publish a concise explanation of how each benchmark determination was developed, and of the extent to which and basis upon which expert judgement was used.
Methodology	The IOSCO Principles: • promote the quality and integrity of methodologies by setting out minimum information that should be addressed within a methodology; • provide guidance on procedures for making changes to a methodology, and the need to have policies and procedures for transition in the event of the cessation of a benchmark; and • require that the methodology be published or made available so that stakeholders may understand and make their own judgements concerning the overall credibility and representativeness of the benchmark.
Submitter conduct	The IOSCO Principles: • address vulnerabilities in the submission process (such as conflict of interest, improper communication between submitters and benchmark administrators, and selective submission of data) by outlining the responsibilities that should be undertaken by submitters; and • state that the administrator should develop a submitter code of conduct outlining these responsibilities, and then monitor and record adherence by submitters.
Accountability	The IOSCO Principles require: • that benchmark administrators establish complaint processes, documentation standards and audit reviews intended to provide evidence of compliance by the administrator with its quality standards; and • that this information be made readily available to regulatory authorities in carrying out their regulatory or supervisory duties.