



ASIC

Australian Securities & Investments Commission

REPORT 440

Financial benchmarks

July 2015

About this report

This report addresses the potential manipulation of financial benchmarks and related conduct issues.

It provides an overview of the importance of financial benchmarks and the need for financial benchmarks to be robust and reliable, and touches on investigations ASIC is undertaking into the occurrence of financial benchmark-related conduct issues.

It also addresses the international and Australian regulatory reforms and other responses to concerns about financial benchmarks, and sets out the measures we encourage financial institutions and benchmark administrators to adopt to avoid conduct issues in the future.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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Executive summary

Financial benchmarks and ASIC's review

- 1 Financial benchmarks (benchmarks) are indices or indicators used as reference prices for financial instruments or contracts, or to measure the performance of investment funds.
- 2 Some benchmarks are systemically important because there may be a risk of financial contagion or instability if the availability or integrity of the benchmark is disrupted.
- 3 In Australia, we consider the following benchmarks to be of potential systemic importance:
 - (a) Bank Bill Swap Rate (BBSW);
 - (b) the Interbank Overnight Cash Rate (cash rate);
 - (c) S&P/ASX 200 equity index;
 - (d) ASX Clear (Futures) Pty Ltd's Commonwealth Government Securities (CGS) yields survey for settling bond futures; and
 - (e) Consumer Price Index (CPI).
- 4 Internationally, we consider the IBOR interest rate benchmark family and the WM/Reuters and European Central Bank (ECB) foreign exchange (FX) 'fix' rates, among other benchmarks, to be systemically important.
- 5 Benchmarks are of critical importance to a wide range of users in financial markets and throughout the broader economy. Different benchmarks affect the pricing of key financial products such as credit facilities offered by financial institutions, corporate debt securities, exchange-traded funds (ETFs), FX and interest rate derivatives, commodity derivatives, equity and bond index futures and other investments and risk management products.¹
- 6 ASIC is investigating financial institutions to test for conduct and other issues relating to financial benchmarks, such as key interest rate and FX benchmarks. Our inquiries are ongoing and are informed by the types of benchmark-related conduct and oversight issues that have been observed overseas.
- 7 We will take enforcement action where we consider there has been conduct that is unlawful under the *Corporations Act 2001* (Corporations Act), *Australian Securities and Investments Commission Act 2001* (ASIC Act) or

¹ Home loan rates will be indirectly affected by changes in interest rate benchmarks, to the extent those benchmarks determine the cost of wholesale funds.

other applicable legislation that we administer, and which otherwise meets our criteria for enforcement action.

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

Regulatory reform

- 9 Concerns about the reliability and robustness of financial benchmarks have led to a number of key reforms, internationally and in Australia.
- 10 Internationally, the International Organization of Securities Commissions (IOSCO) issued the *Principles for financial benchmarks* (IOSCO Principles) in July 2013.² The Financial Stability Board (FSB) has also issued recommendations for benchmark administrators and submitters in the interest rate and FX markets.³
- 11 Peer international jurisdictions, including the United Kingdom, European Union, Canada, Japan, Hong Kong and Singapore, have initiated regulatory reforms to strengthen benchmark administration and submission and, in some instances, to make benchmark manipulation an offence.
- 12 In many cases, the administration of key international benchmarks has undergone reform in response to conduct issues. These measures have also been accompanied by broader market reviews by financial regulators and recommendations issued by international trade associations.
- 13 In Australia, the administration of BBSW was reformed in September 2013 to move from a submissions-based to a market data-based benchmark. Other reforms that are underway relate to the FX market and seek to implement relevant FSB recommendations, in particular, regarding the pricing of 'fix' business.

² IOSCO, [Principles for financial benchmarks: Final report \(PDF 389 KB\)](#), report, 17 July 2013.

³ FSB, [Reforming major interest rate benchmarks](#), report, 22 July 2014 and FSB, [Foreign exchange benchmarks: Final report](#), report, 30 September 2014.

Recommendations for dealers, benchmark administrators, wealth managers and other clients

- 14 Given their importance, it is critical to ensure that financial benchmarks are robust and reliable—and dealers, benchmark administrators and wealth managers all have a responsibility to get this right.
- 15 Dealers are encouraged to review their internal arrangements thoroughly to ensure that conduct issues relating to financial benchmarks do not occur in the future. Internal arrangements include compliance systems, controls, procedures, policies, governance and senior management oversight arrangements, as well as incentive structures. We also encourage dealers in relevant markets, including fixed income and FX markets, to proactively review past conduct to ensure there has been full compliance with the law, and to report to ASIC where required.
- 16 We encourage relevant administrators of systemically-important benchmarks administered in Australia to adopt and implement the IOSCO Principles. We also encourage administrators of non-systemically important benchmarks to adhere to the IOSCO Principles in a proportionate manner that reflects the size and risk of the benchmark and the benchmark-setting process.
- 17 Wealth managers, including superannuation funds, insurers and their fund managers, and other clients of dealers (including authorised deposit-taking institutions (ADIs)), should engage with their dealers to ensure they understand how their dealers have handled (and are handling) their orders and confidential information. To the extent that wealth managers also administer benchmarks, our recommendations for benchmark administrators will also be relevant.

Feedback

- 18 Feedback on the issues raised in this report is welcome and can be sent to: benchmarks-report@asic.gov.au
- 19 We will not treat your feedback as confidential unless you specifically request that we treat the whole or part of it (such as any financial information) as confidential.

A Background

Key points

Benchmarks are indices or indicators used as reference prices for financial instruments or contracts, or to measure the performance of investment funds. Some benchmarks are systemically important because there may be a risk of financial contagion or instability if the availability or integrity of the benchmark is disrupted.

In this section we outline:

- why benchmarks are important in financial markets and throughout the broader economy (see paragraphs 35–44);
- ASIC’s investigation of financial institutions to determine whether benchmark-related misconduct and associated oversight issues have occurred (see paragraphs 45–57); and
- the consequences if benchmarks are not robust and reliable in terms of potential detriment to clients of financial institutions and decreased market confidence (see paragraphs 58–68).

What are benchmarks?

Definitions

- 20 A benchmark can be defined as an index or indicator calculated from a representative set of underlying data or information, used as a reference price for a financial instrument or financial contract or to measure the performance of an investment fund.⁴
- 21 The definition given by IOSCO comprises prices, estimates, rates, indices or values that are:
- (a) made available to users, whether free of charge or for payment;
 - (b) calculated periodically, entirely or partially by the application of a formula or another method of calculation or assessment of the value of one or more underlying interests; and
 - (c) used for reference for purposes that include one or more of the following:
 - (i) determining the interest payable, or other sums due, under loan agreements or under other financial contracts or instruments;

⁴ European Commission, [Proposal for a regulation on indices used as benchmarks in financial instruments and financial contracts: Frequently asked questions](#), MEMO-13-799, press release, 18 September 2013.

- (ii) determining the price at which a financial instrument may be bought, sold, traded, redeemed, or the value of a financial instrument; and/or
 - (iii) measuring the performance of a financial instrument.⁵
- 22 In-line with IOSCO's definition, we do not consider prices of individual securities to constitute benchmarks.⁶
- 23 Benchmark administrators are those entities that are responsible for the calculation of the benchmark, determining and applying the benchmark methodology and disseminating the benchmark. They do so on the basis of observable market transactions (or quoted prices) or submissions. They may already be subject to financial regulation (e.g. as banks, financial services providers, markets or clearinghouses). Other benchmarks are administered by specialist benchmark administrators, many of which are not subject to financial regulation. Some indices are administered by government agencies such as central banks or statistics bureaux.
- 24 Submitters are market participants or other entities that submit information to a benchmark administrator for the purpose of allowing the administrator to calculate a benchmark. Submitters can also be individual employee(s) with responsibility for determining what the submission will be and submitting it to the benchmark administrator. Submissions may be based, for example, on the submitter's view on observable (actual) prices during a defined period, or on prices for notional transactions under defined conditions.

Types of benchmarks

- 25 Submission-based benchmarks are calculated by a benchmark administrator using submissions which are made to it by submitters. Other benchmarks are calculated without any submissions, and are instead based on observable market prices (i.e. transactions and/or quotes).
- 26 Benchmarks of interest to financial regulators can include benchmarks that reference financial indicators (e.g. interest rates, FX, equity price indices and commodity benchmarks (such as crude oil prices)) or other non-financial indicators that are widely referenced by financial instruments.

Systemically-important benchmarks

- 27 Financial benchmarks can be further distinguished between 'systemically-important' or 'critical' benchmarks, and other benchmarks and indices. The

⁵ IOSCO, [Principles for financial benchmarks: Final report \(PDF 389 KB\)](#), report, July 2013.

⁶ IOSCO, [Principles for financial benchmarks: Final report \(PDF 389 KB\)](#), report, July 2013, p. 4.

- distinction can be useful when considering the level of regulatory scrutiny that a particular benchmark merits.
- 28 The systemic importance of a benchmark is related to the risk of financial contagion or financial instability that could be caused if the availability or integrity of the benchmark is disrupted.
- 29 There are a number of possible statistical measures of the systemic importance of a particular financial benchmark. Two simple measures that seek to capture only the direct, and not the economy-wide, impacts, are:
- (a) the size or turnover of derivative positions referencing a particular benchmark; and
 - (b) the amount of debt referencing a particular benchmark, for example, the value of inflation-linked bonds on issue.
- 30 International examples of systemically-important interest rate benchmarks include key interest rate benchmarks such as the London Interbank Offered Rate (LIBOR), Euro Interbank Offered Rate (Euribor), Tokyo Interbank Offered Rate (TIBOR), and key FX benchmarks such as the WM/Reuters 4pm London fix (London 4pm fix) benchmark rates and the 1.15pm European Central Bank fix (ECB fix) benchmark rates. Although administered overseas, many of these benchmarks are systemically important in Australia.
- 31 In Australia, examples of benchmarks of potential systemic importance include the BBSW administered by the Australian Financial Markets Association (AFMA), the cash rate administered by the Reserve Bank of Australia (RBA), the S&P/ASX 200 equity index administered by S&P Dow Jones Indices LLC, the survey of CGS yields conducted by ASX Clear (Futures) for the purpose of settling bond futures, and the CPI official rate, administered by the Australian Bureau of Statistics (ABS).
- 32 There is an important difference in the way that LIBOR and BBSW interest rate benchmarks operate. Before conversion of its methodology to an automated process based on live, executable bids and offers in Prime Bank Eligible Securities,⁷ BBSW relied on submissions of the rates in the market as observed by submitters: see paragraphs 118–121.
- 33 By contrast LIBOR has, and continues to, rely on submissions of each submitter's subjective estimate of the lowest rate at which it could obtain funding in a reasonable market size in the London interbank market just prior to the fixing time.⁸

⁷ Australian Financial Markets Association, [AFMA BBSW: A guide to the Bank Bill Swap \(BBSW\) benchmark rate \(PDF 616 KB\)](#), April 2015.

⁸ ICE Benchmark Administration (IBA), [ICE LIBOR](#).

Other financial benchmarks and indices

- 34 Financial benchmarks and indices extend beyond the category of systemically-important benchmarks and include a broad range of rates and indices used in financial markets and referenced in financial instruments. In Australia, they include:
- (a) equity indices other than the S&P/ASX 200, including a range of other indices covering ASX-listed securities published by S&P Dow Jones Indices LLC; and
 - (b) performance benchmarks and indices referenced in ETFs, managed funds and managed investment schemes.

Why are benchmarks important?

Benchmarks in the Australian economy

- 35 Benchmarks are of critical importance to the financial system and its intermediaries. More importantly, they directly affect both corporate and individual users of the financial system and, through them, the health of the broader economy.
- 36 A broad range of financial products reference benchmarks, with an even broader range of users of those financial products: see Examples 1–6.
- 37 Borrowers (including home borrowers) and lenders (including subscribers of bonds) may have liabilities and interest rates calculated directly or indirectly by reference to interest rate or inflation benchmarks.

Example 1

- As at 31 March 2015, the face value of inflation-linked CGS (Treasury Indexed Bonds) on issue was \$26.4 billion.⁹ These securities reference the CPI benchmark.
- In Australia, the stock of all bank loans was \$2.37 trillion in February 2015,¹⁰ of which home loans made up \$1.34 trillion.¹¹ The pricing of these loans depends on a range of factors, including wholesale funding costs which will be affected by interest rate benchmarks such as BBSW or the cash rate.

- 38 In derivatives markets, dealers and end users (including corporates, superannuation and insurance funds) have a direct interest in financial

⁹ Australian Office of Financial Management (AOFM), [Overview of debt and assets managed by the AOFM \(PDF 220 KB\)](#), 8 April 2015.

¹⁰ RBA, [Money and credit statistics Table D2 Lending and credit aggregates](#).

¹¹ Australian Prudential Regulation Authority (APRA), [Monthly banking statistics: March 2015 \(PDF 358 KB\)](#), 30 April 2015.

benchmarks such as interest rate and FX benchmarks, because payment flows under derivatives will normally be directly linked to the level of such benchmarks.

Example 2

In Australia, the stock of over-the-counter (OTC) interest rate derivatives is \$20.7 trillion and the stock of OTC FX derivatives is \$3.7 trillion.¹² These derivatives reference interest rate benchmarks and FX benchmarks, respectively. Almost half (around 47%) of the gross open notional in the Australian OTC interest rate derivative market in Australia directly references BBSW.¹³

- 39 Regulated financial markets and their market participants have a direct interest in financial products that are traded on-market and which reference financial indices. In Australia, the most notable example is the ASX SPI 200 Index Futures contract.

Example 3

ASX SPI 200 Index Futures are the benchmark derivative product for investors trading and hedging in the Australian equity index market. These contracts reference the level of the S&P/ASX 200 Index. Average daily turnover for ASX SPI 200 Index Futures for the 12 months to September 2013 was approximately \$4.8 billion.¹⁴

- 40 Participants in spot (cash) financial markets, such as FX markets, equity and bond markets (e.g. financial institutions and superannuation funds), depend on reliable price benchmarks to effect trading.
- 41 Commodity derivatives are used by companies as diverse as airlines and mining companies to manage forward price risk, generally by smoothing income or expenses relating to commodities (e.g. fuel, bulk minerals or precious metals) produced or consumed. Financial institutions are also active in these markets, providing liquidity to end-user market participants.

¹² DTCC Data Repository (Singapore) Pte Ltd (DDRS), [Australia public data](#). Figures current as at 10 April 2015.

¹³ Calculated by ASIC using derivative trade repository data.

¹⁴ ASX Limited, [ASX SPI 200™ Futures \(PDF 144 KB\)](#), 29 October 2013.

Example 4

In Australia, the turnover in the 2013–14 financial year of exchange-traded energy futures and options was \$387 billion, and of OTC electricity derivatives was \$251 billion.¹⁵ Commodity derivatives more broadly reference commodity price indices such as electricity, gas, oil and gold indices.

- 42 ETFs and collective investment vehicles such as managed and hedge funds will often have mandates that use a nominated index or benchmark to assess investment manager performance and fees.
- 43 For investment funds that have particular strategies referring to a benchmark (e.g. an ASX 200 fund), fund managers will generally make investment decisions (e.g. to re-weight a portfolio or to invest or divest a particular stock) based on the weighting in that benchmark.

Example 5

The total funds under management of ASX-quoted ETFs referencing equity indices is \$14.8 billion, of which Australian indices represent \$7.5 billion. The total funds under management of ETFs referencing bond indices is \$1.6 billion.¹⁶

- 44 Financial institutions and governments use benchmark rates for financial and investment management purposes, including portfolio revaluation. Investment funds may, for example, have exposure to derivatives and other assets to which benchmarks are important for portfolio management purposes.

Example 6

The assets under management in Australian superannuation funds in the December 2014 quarter was \$1.831 trillion.¹⁷ Each superannuation fund uses benchmarks for asset revaluation purposes. The majority of these funds would also use derivatives for hedging purposes, particularly FX and interest rate derivatives (which themselves mostly reference benchmarks), whether directly in the fund or through an investment entity in which the fund has an interest.

ASIC's ongoing review of benchmark-related conduct

- 45 ASIC is investigating a range of financial institutions to determine whether or not there has been benchmark-related misconduct in Australia's financial markets. Our inquiries are still underway and, given the size and complexity

¹⁵ AFMA, [2014 Australian financial markets report \(PDF 5.98 MB\)](#), report, 1 October 2014.

¹⁶ ASX Limited, [ASX funds \(listed managed investments and ETPs\) monthly update: April 2015 \(PDF 1.09 MB\)](#), 6 April 2015.

¹⁷ ABS, [Managed funds, Australia, Mar 2015](#), cat. no. 5655.0, 28 April 2015.

of the relevant markets, will take some time to complete. We are looking at the activity of Australian financial institutions domestically and overseas, as well as foreign financial institutions that are active in Australia.

- 46 Our investigations are informed by the conduct issues relating to financial benchmarks that have been observed overseas and which have formed the basis of significant settlements by financial institutions with foreign financial regulators. For example:
- (a) trading designed to move a benchmark rate so that the financial institution derives a benefit (e.g. by increasing the value of a derivative position held by the institution that references the benchmark);
 - (b) inappropriate handling of client orders or positions (e.g. by deliberately triggering 'stop-loss' orders);
 - (c) inappropriate disclosure of confidential client information (e.g. by disclosing client orders to traders at competing banks); and
 - (d) inappropriate submitter conduct (e.g. by making submissions in order to reduce the institution's borrowing costs).
- 47 In carrying out our investigations, we will consider whether any misconduct may have resulted from:
- (a) oversight failures (such as inadequate controls, procedures, policies, training and supervision);
 - (b) corporate culture accepting of poor practices and tolerant of non-compliance; and
 - (c) poorly-designed incentives.
- 48 In particular, we will examine whether financial institutions have failed to adequately supervise and control the day-to-day operations and conduct of traders and submitters. We will also investigate whether senior managers were aware of, or were complacent about, any conduct issues that may have been present.
- 49 We are examining relevant documents, including trading data, phone recordings, emails and chat messages. We are conducting voluntary interviews and compulsory examinations of numerous individuals, up to senior management level. We are also requiring a number of financial institutions to undertake their own reviews and/or to provide to ASIC records of reviews already conducted.
- 50 Where we consider it may help our inquiries, or where there are relevant matters to be referred, we are working in coordination with other regulators both within Australia and internationally.
- 51 There are a number of provisions of the Corporations Act and ASIC Act that may be relevant to benchmark-related conduct issues. These provisions

include civil and criminal provisions that apply to particular individuals as well as to financial institutions.

- 52 Provisions of the Corporations Act and ASIC Act with potential relevance include:
- (a) the obligations of Australian financial services (AFS) licensees;
 - (b) market misconduct and other prohibited conduct relating to financial products and financial services; and
 - (c) unconscionable conduct and misleading or deceptive conduct.
- 53 We will take appropriate enforcement action where we consider there has been conduct that is unlawful and which meets our criteria for enforcement action.

Enforceable undertakings accepted by ASIC

- 54 We have accepted enforceable undertakings from UBS AG, BNP Paribas and The Royal Bank of Scotland in relation to financial benchmarks.¹⁸ Each institution reported to ASIC that it had found evidence of conduct seeking to influence its BBSW submissions based on how the submission may have benefitted its derivatives positions.¹⁹ ASIC held concerns that such conduct may have contravened s912A of the Corporations Act relating to AFS licensees' general obligations.
- 55 Each enforceable undertaking requires the financial institution that signed the enforceable undertaking to ensure that its participation in the setting of Australian interest rate benchmarks upholds the integrity and reliability of those benchmarks. For two of the institutions, the enforceable undertakings also require compliance with certain obligations imposed by US Commodity Futures Trading Commission (CFTC) orders.
- 56 Additionally, one financial institution was required to undertake certain remedial measures with respect to its trading activity in Reference Bank Bills. An independent compliance expert was required to review and report on that institution's compliance with the enforceable undertaking in respect of these remedial measures. The independent compliance expert's report confirmed that the policies, procedures and controls implemented are effective in ensuring the outcomes of the enforceable undertaking.

¹⁸ An enforceable undertaking is a negotiated outcome accepted by ASIC in circumstances where ASIC considers it will provide a faster, more flexible and effective regulatory outcome than non-negotiated, administrative or civil sanctions. We consider enforceable undertakings an important component in our array of enforcement remedies to influence behaviour and encourage a culture of compliance.

¹⁹ Media Release ([13-366MR](#)) *ASIC accepts enforceable undertaking from UBS* (23 December 2013), Media Release ([14-014MR](#)) *ASIC accepts enforceable undertaking from BNP Paribas* (28 January 2014), and Media Release ([14-169MR](#)) *ASIC accepts enforceable undertaking from The Royal Bank of Scotland* (21 July 2014).

- 57 The institutions also made voluntary contributions totalling \$3.6 million to fund independent financial literacy projects in Australia.

What are the consequences if benchmarks are not robust and reliable?

- 58 It is in Australia's interests that financial benchmarks are robust and reliable because benchmarks are used in many ways that have direct impacts for individuals and the broader economy.
- 59 Where prices or financial benchmarks fail to reflect genuine forces of supply and demand, financial markets are not able to fulfil their overarching purpose of efficiently allocating capital and risk on the basis of economic fundamentals. If benchmark integrity is compromised, as well as any losses to clients, the impacts may have negative consequences for market confidence. For these reasons, ensuring the integrity of financial benchmarks is of critical importance to financial regulators—and dealers, benchmark administrators, and wealth managers all have a responsibility to get this right.

Detriment to clients

- 60 If benchmarks are not robust and reliable there is the potential for detriment, including direct losses, to clients. Where a benchmark has been manipulated (whether through abusive submissions or manipulative trading practices) to benefit the trading positions of a financial institution, the economic interests of the financial institution's counterparties may be detrimentally affected.
- 61 Where confidential client information has been misused or inappropriately disclosed, clients may have entered trades at less advantageous price levels. For example, where a financial institution has deliberately traded ahead of the client to influence price levels, the client may have lost an opportunity to receive the best possible price.
- 62 Where a financial institution deliberately acts to execute a stop-loss order, known as 'triggering', the client will always incur a direct loss. The financial institution, on the other hand, will use the movements in the price to buy and sell at different rates and derive a profit for itself.

Market confidence

- 63 If financial benchmarks are seen to be open to abuse, financial institutions and end users will tend to lose confidence in those benchmarks. Promoting the confident and informed participation of investors and consumers in the financial system is one of ASIC's statutory objectives: s1(2)(b) of the ASIC Act.

- 64 In a speech delivered on 29 May 2015, ASIC Chairman Greg Medcraft noted that for markets to perform their function, investors need to have trust and confidence in them.²⁰ Confidence in financial benchmarks is an aspect of market confidence generally. If benchmarks referenced in financial contracts are not perceived to be trustworthy or free of manipulation, financial institutions and end users may be less willing to enter into financial contracts, including derivatives contracts, that reference those benchmarks. This in turn would lead to poorer risk management or resource allocation.
- 65 In fact, a decline in general confidence in benchmarks has already led to benchmarks being reformed or replaced. This can involve considerable cost to benchmark administrators and submitters. Where a benchmark is replaced, there may also be disruption to users of the benchmarks, for example, where loan or derivatives documentation needs to be rewritten to reflect changes to arrangements.
- 66 There is also the issue of falling confidence in financial institutions as a result of revelations of misconduct. A large number of internationally-active financial institutions have recently settled with foreign financial regulators in response to allegations of misconduct concerning key interest rate benchmarks such as LIBOR, TIBOR and Euribor (collectively known as IBOR), and key FX benchmarks such as the London 4pm fix and ECB fix.²¹
- 67 For some of these financial institutions and foreign financial regulators, investigations, including those relating to individual misconduct, are still ongoing. Private lawsuits have also been brought by investors against financial institutions in relation to benchmark-related misconduct. Settlements of these proceedings have commenced and are continuing.
- 68 The FSB 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. The implication of this includes withdrawal from correspondent banking facilities, which reduces financial inclusion.²²

²⁰ Greg Medcraft, Chairman, ASIC, [Creating growth through our markets: Using the right nudge](#), speech to the 2015 Annual Stockbrokers Conference, Sydney, 29 May 2015.

²¹ These settlements have taken place with a number of key foreign financial regulators, including the UK Financial Conduct Authority (FCA), CFTC, US Department of Justice, US Office of the Comptroller of the Currency, New York Department of Financial Services, US Federal Reserve, Swiss Financial Markets Regulatory Authority (FINMA), and the European Commission.

²² Mark Carney, Chairman, FSB, [Financial reforms—Finishing the post-crisis agenda and moving forward \(letter to G20 Finance Ministers and Central Bank Governors\)](#) (PDF 76 KB), 4 February 2015, p. 5.

B Regulatory reforms and other responses

Key points

Concerns about the reliability and robustness of financial benchmarks have led to a number of regulatory reforms and other responses both internationally and in Australia.

International responses have included:

- publication of guiding principles and recommendations by official international bodies (paragraphs 72–84);
- introduction of new legislation and regulation in foreign jurisdictions (paragraphs 85–103);
- broader market reviews (paragraphs 104–108);
- reform of benchmark methodologies and governance frameworks by benchmark administrators (paragraph 109); and
- recommendations from trade associations (paragraphs 110–116).

Due to the globally-interconnected nature of these markets, the extensive international responses have helped to inform responses in Australia, including:

- reform of the BBSW calculation methodology (paragraphs 118–121);
- reform of the CGS yields survey for settling bond futures calculation methodology (paragraphs 124–125);
- proposals to establish a risk-free rate (paragraphs 126–127); and
- reforms to FX market (paragraphs 128–132).

International responses

- 69 The scale of international responses to benchmark-related conduct issues reflects the importance of ensuring robust and reliable benchmarks.
- 70 IOSCO and the FSB have assisted in framing the regulatory responses with the development of guiding principles and recommendations. A number of foreign jurisdictions have initiated regulatory reform to make benchmark administration and submission regulated activities, and to make benchmark manipulation an offence.
- 71 There have also been reforms to benchmarks made by benchmark administrators, and recommendations issued by trade organisations and self-regulatory associations, as well as broader reviews of wholesale markets.

Recommendations from official international bodies

IOSCO Principles

- 72 The IOSCO Principles were published in July 2013,²³ and endorsed by the Group of Twenty (G20) at the St Petersburg Summit in September 2013. They are intended to create an overarching framework for the administration of benchmarks used in financial markets. The principles are directed at benchmark administrators and are intended to address vulnerabilities arising from benchmark governance, benchmark quality, methodologies used and accountability arrangements: see Table 1. Importantly, the IOSCO Principles are not intended to supersede existing laws, regulations or relevant regulatory or supervisory frameworks in the various jurisdictions.

Table 1: Summary of the IOSCO Principles

Conduct issue	Details
Governance	<p>The IOSCO Principles ensure that benchmark administrators:</p> <ul style="list-style-type: none"> • 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	<p>The IOSCO Principles:</p> <ul style="list-style-type: none"> • 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	<p>The IOSCO Principles:</p> <ul style="list-style-type: none"> • 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.

²³ IOSCO, [Principles for financial benchmarks: Final report \(PDF 389 KB\)](#), report, 17 July 2013, p 3.

Conduct issue	Details
Submitter conduct	<p>The IOSCO Principles:</p> <ul style="list-style-type: none"> • 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	<p>The IOSCO Principles require:</p> <ul style="list-style-type: none"> • 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.
73	<p>See Appendix 1 for a summary of the reviews conducted to date on the implementation of the IOSCO Principles.</p>
FSB recommendations	
<i>Interest rate benchmarks</i>	
74	<p>In July 2014, the FSB released its report, <i>Reforming major interest rate benchmarks</i>.²⁴ Amongst other guidance and recommendations, the report outlined six principles for change (the FSB Principles): see Appendix 2.</p>
75	<p>The aim of the FSB Principles is not to develop new standards for reference rate benchmarks, but to underpin the framework for change and guide transition to alternative, additional or reformed rates. The FSB intends for the principles to guide public authorities and benchmark administrators in promoting reform to reference rates or in encouraging a transition to alternative rates.</p>
76	<p>For example, the report recommends that central banks and supervisory authorities encourage industry, or work with the benchmark administrators, to implement at least one IOSCO-compliant risk-free rate by the second quarter of 2016.²⁵</p>
77	<p>The FSB states that the overarching objective should be to transition to rates that are anchored in actual transactions (i.e. derived mechanically from transacted data without use of expert judgement). Where, due to market liquidity, depth and data sufficiency, there may be insufficient transactions available in the market to allow pure transaction rates, the preference is for rates derived on a waterfall of different data types with underlying market</p>

²⁴ FSB, [Reforming major interest rate benchmarks](#), report, 22 July 2014.

²⁵ A risk-free rate is a benchmark that does not include a credit risk component unlike, for example, LIBOR or BBSW.

transactions first, then transactions in related markets, then committed quotes, and then indicative quotes.

78 The FSB Principles state that in pursuing the objective of moving to transactions-based rates, transition risks and costs should be minimised as much as possible. Any costs arising from transition should be borne in a proportionate manner amongst market participants and not unduly impact the real economy.

79 The FSB Principles also state that public authorities have a responsibility to ensure that the financial institutions they regulate do not use reference rates in any way that poses undue risk to the institutions themselves, to market integrity or to overall financial stability.

FSB recommendations for FX benchmarks

80 The FSB published recommendations for reform in the FX market on 30 September 2014: see Appendix 2.²⁶ The 15 recommendations are proposed to address the incentives and opportunities for improper trading behaviour of market participants around the fix, and to address the methodology for computing the fix, with a focus on the London 4 pm fix benchmark.²⁷

81 It was recommended that the fixing window be widened from its current width of one minute to five minutes for the major currencies, to strike a balance between reducing incentives for manipulation while at the same time ensuring the fix is fit for purpose by generating a replicable market price. It was also recommended that price feeds and transaction data be incorporated from a broader range of sources to increase coverage of the FX market during the fixing window.

82 In response to these recommendations, on 16 February 2015 the administrator of the WM/Reuters 4pm London Closing Spot Rates, the World Markets (WM) Company, widened the window used to calculate FX benchmark fixes from one minute to five minutes and began to incorporate more data feeds.²⁸

83 A number of the recommendations relate to removing the incentive and opportunity for dealers to engage in inappropriate conduct. For example, it was recommended that:

- (a) fixing transactions be priced in a manner that is transparent and consistent with the risk borne by the dealer in accepting the transaction at a yet-to-be-agreed price, via a bid-offer spread or through a clearly

²⁶ FSB, *Foreign exchange benchmarks: Final report*, report, 30 September 2014.

²⁷ The recommendations arose from a formal review undertaken by IOSCO to identify the degree of implementation of the IOSCO Principles by WM as administrator of the London 4pm fix benchmark.

²⁸ HM Treasury, Bank of England, FCA, *Fair and Effective Markets Review: Final report*, report, June 2015.

communicated and documented fee structure such as a direct fee or contractually-agreed price;²⁹ and

- (b) banks and other FX dealers separate their fixing business from their regular business. The primary aim of this recommendation is to reduce the likelihood of inappropriate use of the information obtained from the fixing orders.

84 Other recommendations regarding the behaviour of market participants include that:

- (a) market-makers should not share information with each other about trading positions, whether for individual trades or aggregate positions; and
- (b) banks should:
 - (i) establish and enforce internal systems and controls to address potential conflicts of interest; and
 - (ii) detail more precisely and explicitly in their code of conduct, best practices for information sharing and execution of FX transactions, including fixing orders.

Regulatory reforms

85 Regulatory reforms to address financial benchmark issues have been introduced or proposed in the United Kingdom, European Union, Canada, Hong Kong, Japan and Singapore: see Appendix 3 for a detailed summary of regulatory responses by jurisdiction.

86 These regulatory responses have been largely based on the IOSCO Principles and generally focus on improved corporate governance and control arrangements, including:

- (a) regulating benchmark administration;
- (b) regulating the behaviour of benchmark submitters; and
- (c) provisions relating to the recognition of extraterritorial benchmarks.

87 Some regulatory responses include new market manipulation provisions which make manipulative conduct in relation to a benchmark a criminal offence punishable by a fine or imprisonment.

²⁹ The recommended pricing would help to provide greater clarity and transparency around the transaction cost borne by the customer and the risk borne by the dealer in accepting the transaction at a yet-to-be-agreed price. As dealers often agree to trade at mid-market rates rather than at the bid or ask, customers are not passed the cost of transactions in the traditional, direct manner. This adds to the pressure on dealers to make a return from the price movements. Dealers also face the risk that the market may move strongly against them before the fix, resulting in a potential for large losses.

Regulating benchmark administration

- 88 In 2013, the United Kingdom made amendments under the *Financial Services and Markets Act 2000* (UK) to bring the administration of LIBOR within the scope of financial regulation.³⁰ In April 2015, seven additional benchmarks, including the London 4pm fix, were brought into this regulatory framework,³¹ and the FCA introduced Chapter 8 of the FCA Handbook (MAR 8) containing rules and guidance for benchmark administrators.
- 89 The European Commission has also officially proposed a new regulation on benchmarks.³² The proposal would make benchmarks 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. This proposal was recently approved with amendments by the European Parliament, and is currently subject to negotiations between the European Parliament, the European Commission and the European Council.
- 90 Draft legislation proposed 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’.
- 91 Similar changes have also been made in Japan and are proposed in Singapore.

Regulating benchmark submission

- 92 Benchmark submission has been made a regulated activity in the United Kingdom under the Financial Services and Markets Act (UK),³³ and MAR 8 contains rules and guidance for benchmark submitters in addition to those for benchmark administrators.
- 93 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.

³⁰ The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2013 (UK).

³¹ The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2015 (UK). See Appendix 3 for details of the additional benchmarks.

³² European Commission, [Proposal for a Regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts](#).

³³ The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2013 (UK).

- 94 The European Commission has proposed, and Japan has adopted, indirect regulation on submitters (i.e. 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.
- 95 The proposed regulatory framework in Singapore would also subject benchmarks submitters to regulation, and the 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.

Market manipulation changes

- 96 In the United Kingdom it is now a criminal offence, punishable by imprisonment of a maximum of seven years, under the *Financial Services Act 2012* (UK) 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.
- 97 In the European Union, Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation), was recently finalised and will enter into force in July 2016. Under the market abuse regulation, market manipulation of benchmarks includes:
- (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.
- 98 In the European Union the offence will be punishable by a minimum term of imprisonment of four years. Additional administrative sanctions 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.
- 99 The draft legislation proposed in Canada creates two criminal offences relating to benchmarks, both punishable by imprisonment for a term of not more than 10 years:
- (a) The first proposed offence is providing another person with information for the purpose of determining a benchmark knowing, or being reckless as to whether, the information is false or misleading.

- (b) The second proposed offence is engaging in conduct relating to a benchmark with the intent to produce a false or misleading determination of the benchmark.

100 The proposed reforms in Singapore include the creation of a new criminal offence of manipulation of financial benchmarks to be punishable by a maximum imprisonment of seven years.

Extraterritorial application of benchmark regulation

101 Given the international nature of capital markets, and the domestic nature of regulation and supervision, regulatory responses need to include workable provisions for third-country benchmark administrators.

102 The regulation proposed by the European Union for benchmarks will have extraterritorial application. EU-supervised entities will be able to use a financial benchmark that is administered by an administrator located in a third country only if the European Commission has recognised that the administrator is supervised in a jurisdiction with a legal framework and supervisory practice equivalent to that of the European Union (an equivalence decision). Under amendments adopted by the European Parliament, further channels allowing recognition by the European Securities Markets Authority (ESMA) would be available where no equivalence decision has been made.

103 The Japanese regulations exempt foreign administrators of specified financial benchmarks from regulation in Japan if they are adequately supervised by financial regulators in their home jurisdiction.

Broader reviews of wholesale markets

104 Financial regulators have recently begun placing greater emphasis on wholesale markets regulation. Wholesale markets clearly impact the broader economy through their corporate and individual end users (including investors and borrowers).

105 In the United Kingdom, the Fair and Effective Markets Review—a review of the wholesale fixed-income, credit and commodity (FICC) markets led by the Bank of England and co-chaired by the FCA and HM Treasury—was established to conduct a comprehensive and forward-looking assessment of the way wholesale financial markets operate. The review aims to help restore trust in those markets in the wake of a number of recent high-profile abuses, and to influence the international debate on trading practices. The review's interim recommendations led to seven additional benchmarks being brought into the UK benchmark regulatory regime as of April 2015: see paragraph 88.

- 106 The review's final recommendations were published in June 2015.³⁴ In relation to FICC benchmarks, the review recommended that the IOSCO taskforce on financial benchmarks:
- (a) consider exploring ways to ensure that more consistent self-assessments against the IOSCO Principles are published by benchmark administrators, to continue raising the standards of benchmark administrators; and
 - (b) review the use of benchmarks and consider developing a set of guidance for users of benchmarks to encourage users to:
 - (i) regularly review whether their use of benchmarks matches their requirements;
 - (ii) have contingency plans to deal with potential interruption of a benchmark;
 - (iii) conduct due diligence on transactions executed at benchmark fixes;
 - (iv) take an active interest in benchmark design and ongoing development; and
 - (v) consider whether the administrators of benchmarks that are being used have taken appropriate steps to comply with the IOSCO Principles.
- 107 Other recommendations seek to improve conduct in FICC markets and to establish more effective forward-looking supervisory mechanisms: see Table 2 for details of select recommendations arising from the review.

Table 2: Summary of select recommendations from the Fair and Effective Markets Review

Category	Examples of recommendations
Benchmarks	See paragraph 106.
Raise standards, professionalism and accountability of individuals	Issue guidance on minimum standards of training and qualifications, including a requirement for continuing professional development. Develop a mandated form for regulatory references to improve a firm's ability to investigate an individual's past conduct effectively.
Improve the quality, clarity and market-wide understanding of FICC trading practices	The senior leadership of FICC market participants should create a new FICC Market Standards Board to: <ul style="list-style-type: none"> • report on emerging risks where market standards could be strengthened; • address areas of uncertainty in trading practices by producing guidelines and practical case studies; • promote adherence to standards and good practices on control and governance structures; and • contribute to international convergence of standards.

³⁴ HM Treasury, Bank of England, FCA, [Fair and Effective Markets Review: Final report](#), report, June 2015.

Category	Examples of recommendations
Strengthen regulation of FICC markets in the United Kingdom	<p>Create a new statutory civil and criminal market abuse regime for spot foreign exchange.</p> <p>Introduce legislation to extend elements of the Senior Managers and Certification Regimes to all those active in FICC wholesale markets.</p> <p>Lengthen the maximum sentence for criminal market abuse from seven years imprisonment to ten years.</p>
Launch international action to raise standards in global FICC markets	<p>Develop a single global FX code.</p> <p>The FSB should examine further ways to improve the alignment between remuneration and conduct risk at a global level.</p>
Promote fairer FICC market structures while also enhancing effectiveness	<p>Improve transparency in ways that also maintain or enhance the benefits of diverse trading models.</p> <p>Promote choice, diversity and access by monitoring and acting on potential anti-competitive structures or behaviour.</p>
Enhance forward-looking conduct risk identification and mitigation	<p>Enhance surveillance of trading patterns and behaviour by financial institutions and authorities.</p>

108 We expect international regulators and standard-setting bodies to continue to focus on conduct issues over the medium term.

Reforms by administrators of financial benchmarks

109 Internationally, there have been numerous reforms undertaken by benchmark administrators designed to reduce vulnerability to manipulation and to implement recommendations and requirements of official bodies, regulators and trade associations. These reforms include:

- (a) the transition of LIBOR to a new administrator in early-2014, and the introduction of new surveillance systems and statistical analysis techniques to allow closer scrutiny of submitters, including by comparing submission data with related markets, and with a submitting entity's own submission history and that of other submitter entities;
- (b) changes made by the administrator of the Euribor benchmark to its governance framework and to address data quality issues, following recommendations made by ESMA and the European Banking Authority;³⁵
- (c) changes to the London 4pm fix calculation methodology in accordance with the FSB recommendations for FX benchmarks (see paragraphs 81–82);
- (d) the replacement of the London Gold Fix with the London Bullion Market Association (LBMA) Gold Price from 20 March 2015, which is now administered by ICE Benchmark Administration and determined

³⁵ ESMA, [Review of the implementation of EBA-ESMA recommendations to Euribor-EBF](#), report, 20 February 2014.

according to an electronic auction process twice daily. Similar changes have been made to other precious metals benchmarks; and

- (e) the renaming of ISDAFIX as the ICE Swap Rate, and the transition from a submission-based methodology using inputs made by a panel of financial institutions to a new methodology calculated using tradable quotes sourced from regulated electronic trading venues.³⁶

Recommendations from trade associations

Global Financial Markets Association

- 110 In November 2012, the Global Financial Markets Association (GFMA)³⁷ finalised its *Principles for financial benchmarks* (GFMA Principles) to draw attention to the need for international standards to govern financial benchmarks, to serve as a basis for developing international standards, and to urge their adoption by entities responsible for developing and issuing benchmarks.³⁸
- 111 IOSCO subsequently considered the GFMA Principles in the formulation of the IOSCO Principles,³⁹ and many common components are evident across the two sets of principles.

ACI The Financial Markets Association (ACI)

- 112 ACI, an association for wholesale financial market participants, released the ACI Model Code in February 2015.⁴⁰ The code provides guidelines and recommended best practices on a range of conduct issues for participants across the whole of the FICC markets.
- 113 In relation to FX Benchmark orders, the ACI Model Code prescribes that dealers:
- (a) should not disclose any pre-trade information, including the direction and size of the trade;
 - (b) should at all times act in the best interest of their customers;
 - (c) where appropriate, should disclose any potential conflict of interests to the customer;

³⁶ Intercontinental Exchange, [ICE Benchmark Administration \(IBA\) ICE Swap Rate](#).

³⁷ The GFMA brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe in London and Brussels, the Asia Securities Industry & Financial Markets Association in Hong Kong and the Securities Industry and Financial Markets Association in New York and Washington are, respectively, the European, Asian and North American members of GFMA.

³⁸ GFMA, [Principles for financial benchmarks](#), 30 November 2012.

³⁹ IOSCO, [Principles for financial benchmarks: Final report \(PDF 389 KB\)](#), report, 17 July 2013, p 3.

⁴⁰ ACI, [The Model Code](#), February 2015.

- (d) should not, whether by collusion or otherwise inappropriate sharing of information, influence the exchange rate; and
- (e) should not intentionally influence benchmark fixings in an attempt to benefit from the fixing.

114 The ACI Model Code also requires dealers to ensure that information imparted is not false or misleading to avoid manipulating the calculation of a benchmark.

FX committees

115 Most recently, on 30 March 2015, the eight FX committees of the major financial centres⁴¹ released the collaboratively prepared *Global preamble: Codes of best market practice and shared global principles* (Shared Global Principles).⁴²

116 The principles are intended to be incorporated into the processes and control frameworks of FX market participants in a timely manner, but are not intended to replace the individual codes established and adopted by each of the eight FX committees.⁴³ The principles are grouped into three topics—personal conduct, confidentiality and market conduct, and policies for execution practices.

Australian responses

117 In Australia, the administration of BBSW was reformed in 2013, moving from a submissions-based to a market data-based benchmark. The administration of the CGS yield survey was similarly reformed in 2014. Reforms have also been proposed for the FX market seeking to implement relevant FSB recommendations.

Reforms to interest rate-setting mechanisms

AFMA's reform of BBSW

118 AFMA, as the administrator of the BBSW, is responsible for the methodology used in the calculation of the BBSW.

119 In response to international developments and following the withdrawal of some of the international financial institutions from the BBSW submission process, AFMA, in consultation with ASIC and the RBA, changed the

⁴¹ Australian Foreign Exchange Committee; Canadian Foreign Exchange Committee; ECB's Foreign Exchange Contact Group; Hong Kong Treasury Markets Association; London Foreign Exchange Joint Standing Committee; New York Foreign Exchange Committee; Singapore Foreign Exchange Market Committee; Tokyo Foreign Exchange Market Committee.

⁴² Australian Foreign Exchange Committee, [Global preamble: Codes of best market practice and shared global principles \(PDF 88 KB\)](#), 30 March 2015.

⁴³ The Australian Foreign Exchange Committee does not produce and maintain its own code, but rather endorses the ACI Model Code.

method for calculating the BBSW in September 2013. The methodology previously involved submitters submitting their view of the mid-rate for bank bills and certificates of deposit of varying maturities to AFMA by 10.05 am each business day (Australian Eastern Standard Time).

- 120 BBSW is now calculated according to an automated process using live and executable prices from approved venues in the market for Prime Bank Eligible Securities as the price-discovery mechanism.
- 121 AFMA's adoption of an automated process that extracts these rates directly from observable transactions removes the need for submissions and is designed to ensure that BBSW remains underpinned by an actively-traded market.⁴⁴

AFMA's Rate contribution best practice principles

- 122 In March 2013, AFMA published its *Rate contribution best practice principles* (the AFMA Principles).⁴⁵ The AFMA Principles apply to entities that contribute a rate to an administrator for the purpose of the administrator calculating and publishing a benchmark rate for reference by financial market participants (i.e. submitters).
- 123 The AFMA Principles have been developed to provide a common understanding of the internal controls, systems and policies that should be implemented to ensure the integrity and reliability of an entity's rate contribution. The AFMA Principles require:
- (a) prevention of improper communications that attempt to influence the rate contribution for the benefit of financial product dealing;
 - (b) segregation of the contributing officer and the traders who deal in the financial products that reference the benchmark rate so that they cannot readily communicate;
 - (c) retention of records relating to the rate contribution process for a period of seven years;
 - (d) monitoring systems or exception reporting systems to identify possible unsubstantiated or non-conforming rate contributions;
 - (e) training for all relevant staff on both the technical aspects of the rate contribution, and the policies and controls relating to the rate contribution procedures;
 - (f) procedures for managing conflicts of interest; and
 - (g) handling and reporting of complaints or unlawful activity concerning the rate contribution, and appropriate disciplinary responses.

⁴⁴ AFMA, [Bank Bill Swap \(BBSW\) benchmark rate: Conventions \(PDF 319 KB\)](#), 13 April 2015 and AFMA, [AFMA BBSW: A guide to the Bank Bill Swap \(BBSW\) benchmark rate \(PDF 616 KB\)](#), April 2015.

⁴⁵ AFMA, [Rate contribution best practice principles \(PDF 137 KB\)](#), March 2013.

ASX's reform of CGS yields for settling bond futures

- 124 As the administrator of the CGS yields survey for settling bond futures, ASX Clear (Futures) is responsible for the methodology used to calculate the CGS yields.
- 125 In September 2014, ASX Clear (Futures) implemented a new process for calculating the futures contract expiry settlement price for the three and 10 year Commonwealth Government Bond futures. The new process uses a national best bid and offer (NBBO) approach using live, executable prices taken from the Yieldbroker, ICAP and BGC markets. It replaced the previous process which had used the polling of interbank dealers for buy and sell quotes.⁴⁶

Proposed establishment of a risk-free rate

- 126 Work by the FSB on international financial benchmarks supports the development of a more diverse range of interest rate benchmarks on the basis that certain financial transactions are better suited to reference rates that are closer to risk-free. The FSB's objectives in this work are aligned to those of the Bank of International Settlements (BIS).⁴⁷
- 127 ASIC and the RBA are working with industry through AFMA to develop a robust risk-free interest rate benchmark in the local market that meets the needs of market participants, while addressing the objectives of the FSB.

Reforms to FX markets

Implementing the Shared Global Principles and FSB recommendations

- 128 In a speech delivered on 12 February 2015, RBA Assistant Governor Guy Debelle noted that the Shared Global Principles have been adopted to varying degrees, but that there is still substantial scope for further progress.⁴⁸
- 129 He made particular mention of the fact there has not been significant progress in terms of the pricing and execution of fix business within institutions, and reiterated the need for widespread adoption across the industry of the practice of charging for fix business.
- 130 The speech also emphasised that although the recommendations are not explicitly embodied in regulation, there is a strong expectation that they will

⁴⁶ ASX, [Notice: Implementation of ASX 24 bond futures expiry price process \(PDF 124 KB\)](#), notice reference number 0998.14.09, 9 September 2014.

⁴⁷ BIS, [Towards better reference rate practices: A central bank perspective](#), March 2013. BIS is comprised of 60 member central banks representing countries from around the world. It coordinates regulations in the fields of financial services to promote international financial stability.

⁴⁸ Guy Debelle, Assistant Governor (Financial Markets), RBA, [FX benchmarks](#), address to the FX Week Australia Conference, Sydney, 12 February 2015. Guy Debelle is also Chairman of the Australian Foreign Exchange Committee and Co-Chair of the FSB FX Benchmarks Working Group.

be implemented. If these recommendations are not acted on, authorities are likely to conclude that regulatory responses are necessary to generate the desired improvement in market structure and conduct, and the likelihood of a regulatory response will increase.

131 The BIS recently announced that a working group of the Markets Committee chaired by Guy Debelle, will work towards establishing a single global code of conduct for the FX market with a view to promoting greater adherence to these standards and principles.⁴⁹

132 The FSB is also focused on the progress of FX benchmark reform. FSB Chairman Mark Carney has asked FX committees globally, including the Australian Foreign Exchange Committee, to report by the end of July 2015 on market participants' progress in implementing the FSB recommendations for FX benchmark reform.⁵⁰ The FSB will collate the responses and publish an assessment of progress ahead of the G20 Leaders' Summit in November 2015.

Further regulatory reform

133 There may be a need for further regulatory reforms to address the issues discussed in this report. Further reforms would be subject to a process of consultation and questions arising may include:

- (a) whether, and if so how, to apply the IOSCO Principles to the administration of systemically-important benchmarks and benchmark submission processes; and
- (b) what, if any, regulatory reform is desirable in relation to financial benchmark conduct issues.

⁴⁹ BIS, [Economic Consultative Committee statement on FX market best practices](#), press release, 11 May 2015.

⁵⁰ Mark Carney, Chairman, FSB, [Implementation of FSB recommendations for FX benchmarks reforms \(letter to Guy Debelle, Chairman, Australian Foreign Exchange Committee\)](#) (PDF 171 KB), letter, 20 March 2015.

C Recommendations for dealers, benchmark administrators and wealth managers

Key points

In this section we outline the measures dealers, benchmark administrators and wealth managers should adopt to avoid conduct issues in relation to financial benchmarks in the future.

Dealers

Review of oversight, culture and incentives

- 134 Dealers subject to ASIC's oversight include both AFS licensees and foreign financial services providers exempt by legislative instrument from holding an AFS licence because they are subject to sufficiently-equivalent regulatory regimes in certain home jurisdictions: see Information Sheet 157 *Foreign financial services providers: Practical guidance* (INFO 157).
- 135 Due to the extent of benchmark-related misconduct identified overseas and the international nature of participation in wholesale markets, we consider the obligations on AFS licensees to act efficiently, honestly and fairly and to have adequate risk management systems and resources means those entities should thoroughly review their internal arrangements to minimise the risk of benchmark-related conduct issues occurring. Foreign financial services providers should also be subject to substantially-equivalent risk management obligations in their home jurisdictions, which similarly entail the need for a thorough review.
- 136 One way for dealers to minimise the risk of benchmark-related conduct issues occurring is to undertake thorough reviews of their compliance systems, controls, procedures, policies, governance and senior management oversight arrangements, and incentive structures.
- 137 Such reviews will aim to ensure that:
- (a) senior management is not disengaged and complacent;
 - (b) senior management exercises due oversight of trading functions and complies with firm policies and the law at all times; and
 - (c) internal arrangements foster a culture that fully addresses conduct risk.

- 138 Culture is a set of shared values or assumptions reflecting the underlying mindset of an organisation.⁵¹ It shapes and influences the attitudes and behaviours of the financial institution and its staff towards, for example, customers and compliance. There is, therefore, a strong connection between poor culture and poor conduct.
- 139 To create a culture that drives good conduct, institutions are encouraged to focus on the ‘Three C’s’ framework on conduct risk—communication, challenge, complacency: see paragraph 144.
- 140 Poorly-designed incentives are central to misconduct. However strong the compliance structures that are put in place, poorly-designed incentives will inevitably increase the risk of non-compliance with legal requirements at the individual level. It is crucial that firms recognise performance in a way that not only promotes good conduct, but penalises poor conduct as well—by selecting appropriate drivers of pay and bonuses, and triggers for non-monetary incentives such as development opportunities (e.g. conferences, assignments or promotion).
- 141 Training must also be kept up-to-date and refresher training should be conducted for all staff, including senior staff, to ensure that entrenched practices and cultures that may not be compliant are addressed.
- 142 We consider that the principles developed by IOSCO and the FSB, and the recommendations from trade associations, are a useful guide for financial institutions to consider when conducting a review.

Conduct risk

- 143 Benchmark-related conduct issues may be indicative of a failure by financial institutions to appropriately manage their broader conduct risk. We recently undertook a survey of 21 investment banks’ appetite, attitude, and approach to conduct risk. The surveyed investment banks included a cross-section of the major domestic investment banks, and investment banks in the United States, European Union and throughout Asia that have significant operations in Australia.
- 144 The survey led to discussion with business leaders about better practices, impediments and concerns across the industry. To create awareness of identified weaknesses, we have developed the ‘Three C’s’ framework on conduct risk:
- (a) *Communication*: Communications regarding conduct expectations need to be clear, concise, proactive and repeated regularly across all levels of the organisation. Communication strategies should be ongoing to ensure

⁵¹ Greg Tanzer, Commissioner, ASIC, [The importance of culture to improving conduct within the financial industry](#), speech to the Thomson Reuters Third Australian Regulatory Summit, Sydney, 27 May 2015, p. 1.

consistency of messaging and to not allow for complacency. Communication strategies should identify meaningful bottom-up validation to ensure the message is embedded.

- (b) *Challenge*: Institutions and their employees should challenge existing practices to determine whether current conduct and behaviours are appropriate. Institutions should also foster an environment where employees are encouraged to escalate potential practices or conduct issues, and consider rewarding staff for ‘speaking up’.
- (c) *Complacency*: It is dangerous to think that just because something has not happened yet, it will not happen. Conduct risk should continually be reviewed, enforced and validated in the same way that other key risks are (e.g. market, credit, liquidity and operational risks).

Financial services providers’ self-reporting obligations

- 145 AFS licensees are required to report to ASIC significant breaches of certain AFS licence obligations under s912D of the Corporations Act. The obligation to report breaches must be completed in a timely manner once an AFS licensee becomes aware of a notifiable breach. There are also breach reporting obligations under the conditions of various legislative instruments for foreign financial services providers⁵² which require the provider to report to ASIC if it fails to comply with the regulatory requirements of its home jurisdiction.
- 146 Part 5.11 of the ASIC market integrity rules for the ASX, Chi-X and APX markets also contain suspicious activity reporting obligations.⁵³ Under the relevant market integrity rules for each market, a market participant must notify ASIC if it has reasonable grounds to suspect that a person has placed an order or entered into a transaction while in possession of inside information, or which has the effect of creating or maintaining an artificial price or a false or misleading appearance in the market or price for trading in financial products.
- 147 There are further obligations to submit suspicious matter reports to the Australian Transaction Reports and Analysis Centre (AUSTRAC) under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* and the *Financial Transaction Reports Act 1988*.
- 148 We urge dealers in relevant markets, including fixed income and FX markets, to proactively review past conduct to ensure there has been full compliance with the law, and to make remedial reports where required.
- 149 To ensure that reviews conducted by AFS licensees and foreign financial services providers are effective, all available records should be considered,

⁵² Information Sheet 157 [Foreign financial services providers: Practical guidance](#) (INFO 157).

⁵³ Part 5.11 of the ASIC Market Integrity Rules (ASX Market) 2010, ASIC Market Integrity Rules (Chi-X Australia Market) 2011 and of the ASIC Market Integrity Rules (APX Market) 2013.

including voice recordings and chatroom sessions. Additionally, because activities involving Australian benchmarks are not limited to activities in Australia, for completeness, reviews should include the overseas activities of Australian financial institutions and activities of foreign financial institutions that have a connection to Australia.

Other relevant obligations of financial services providers

- 150 An AFS licensee's obligations to comply with the financial services laws will involve developing and implementing measures to prevent recurrent breaches of the Corporations Act and/or the ASIC Act arising from conduct issues that it may identify in its activities.
- 151 The Corporations Act requires all AFS licensees to have adequate resources to provide the relevant financial services and to carry out supervisory arrangements. Compliance with this obligation would mean that each AFS licensee's risk and compliance divisions have appropriately-experienced and trained professionals. Having adequate human and technological resources means each AFS licensee can conduct appropriate supervision of trading activity which reflects the nature, scale and complexity of its business. The supervision should be conducted with appropriate frequency across all available communication channels, reflecting the level of usage of the relevant medium.
- 152 Financial institutions should also ensure their legal obligations to record officers' activities and to preserve records are strictly complied with. Keeping and retaining records appropriately (including retaining them for an adequate period) is necessary to effectively monitor, detect, mitigate and self-report conduct issues.
- 153 Equivalent obligations will ordinarily apply to foreign financial services providers under the regulatory regime of their home jurisdiction.

Benchmark administrators

- 154 We encourage administrators of systemically-important benchmarks administered in Australia to adopt and implement the IOSCO Principles, to the extent they have not already done so: see paragraph 31. However, we recognise that the specific nature of the CPI benchmark does not lend itself to the IOSCO Principles because the principles do not apply to benchmarks administered by national authorities for public policy purposes.
- 155 In relation to non-systemically important benchmarks, we consider that misconduct risk can be mitigated if administrators of these benchmarks apply the IOSCO Principles in a proportionate manner. For this purpose, a 'proportionate manner' is a manner that reflects the size and risk of the benchmark and the benchmark-setting process (e.g. whether it is calculated

based on submissions or transaction data). For example, the IOSCO Principles might be applied to a number of proprietary benchmarks that are predominantly created by ETFs as the investment objective of the fund and against which performance is measured.

- 156 Administrators of benchmarks and other indices (whether or not they are identified as systemically important) are also encouraged to self-assess against the IOSCO principles and other relevant recommendations—and are encouraged to publish the results of self-assessments to promote a broader understanding of the benchmark’s governance, conflicts management and methodology.
- 157 There may be a need for further regulatory reforms to address the issues raised in this report. One factor that will inform consideration of any such reforms will be the extent to which benchmark administrators adopt, and are seen to adopt, the IOSCO Principles.

Wealth managers and other clients

- 158 Wealth managers, such as superannuation funds and insurers (and their fund managers), and other clients (including ADIs) of dealers, also have an important role to play in minimising the risk of financial benchmark conduct issues.
- 159 We encourage wealth managers and other clients of dealers to engage with their dealers to make sure they understand how their orders and confidential information have been (and are being) handled to ensure their legitimate interests and those of any beneficiaries to whom fiduciary obligations are owed are not (and have not been) compromised. We also encourage them to conduct their own due diligence on execution by dealers. It cannot be assumed that trading at a benchmark rate necessarily represents the best execution available.
- 160 To the extent that wealth managers (or their related entities) also administer benchmarks, our recommendations for benchmarks administrators will be relevant. Of particular relevance are benchmarks that underpin ETFs or other collective investment vehicles.

Appendix 1: Summary of reviews on the implementation of the IOSCO Principles

- 161 IOSCO has published three reports reviewing the implementation of the IOSCO Principles:
- (a) [Review of the implementation of IOSCO's Principles for financial benchmarks by administrators of Euribor, LIBOR and TIBOR \(PDF 1.35 MB\)](#), 22 July 2014 (the July 2014 review);
 - (b) [Review of the implementation of IOSCO's Principles for financial benchmarks by WM in respect of the WM/Reuters 4.p.m Closing Spot Rate \(PDF 1.47 MB\)](#), 30 September 2014 (the September 2014 review); and
 - (c) [Review of the implementation of IOSCO's Principles for financial benchmarks \(PDF 658 KB\)](#), 25 February 2015 (the February 2015 review).

Table 3: Summary of IOSCO reviews on the implementation of the IOSCO Principles

Review	Summary
July 2014 review	<p>The July 2014 review concluded that the administrators of Euribor, Libor and Tibor had made good progress in implementing governance-related policies and processes, but had some way to go in ensuring the principles on benchmark design, data sufficiency and transparency of benchmark determinations are implemented.</p> <p>In particular:</p> <ul style="list-style-type: none"> • none of the administrators provided the IOSCO review team with all of the required data to demonstrate compliance with the data sufficiency principle; • none of the administrators were compliant with the principle on transparency of benchmarks, because they did not publish the required explanations with each benchmark determination; and • the administrators were yet to adopt benchmark designs that result in an accurate and reliable representation of the economic realities of the interest that the benchmark seeks to represent. <p>Note: The July 2014 review recommended that a follow-up review of the implementation of the IOSCO Principles by the administrators of Euribor, Libor and Tibor be carried out in 2015.</p>

Review	Summary
<p>September 2014 review</p>	<p>The September 2014 review concluded that WM has demonstrated implementation of some principles but still needed to do substantial work to implement many of them:</p> <ul style="list-style-type: none"> • <i>Governance and transparency</i>: The review concluded that WM's oversight and control structure with respect to the determination process is informal and insufficiently tailored, that WM should put in place an oversight function with the purpose of ensuring the integrity of the benchmark rate, and that WM should adopt a conflicts of interest policy. • <i>Benchmark quality and methodology</i>: The review concluded that WM demonstrates some compliance with the principle of data sufficiency because its benchmark is sourced from observable transactions and largely complies with Principle 8 by having a clear hierarchy of data inputs. The review identified that WM should continue working with data providers to ensure that the transactions used to determine the benchmark rate are <i>bona fide</i> (i.e. executed at arm's length). <p>Note: The September 2014 review recommended that a follow-up review of the implementation of the IOSCO Principles by WM in respect of the WM/Reuters 4pm closing spot rate be carried out in 2015.</p>
<p>February 2015 review</p>	<p>The February 2015 review was conducted by taking a sample of 36 benchmarks (provided by 23 administrators) that are either widely used or sector-specific benchmarks across a variety of regions and assets classes. The review was based only on administrators' self-assessments of their compliance with the IOSCO Principles as collected through a questionnaire and by examination of any published statements of compliance, without any challenge or substantiation of the information by IOSCO.</p> <p>The review found that:</p> <ul style="list-style-type: none"> • there has been a significant market reaction to the IOSCO Principles with widespread efforts being made to implement the principles, although only about a third of the reviewed administrators self-assess their efforts as being complete; • most action has been taken in relation to benchmark administrators' governance arrangements; • some administrators reported having made changes to the nature and quality of data used in benchmark determinations, including a number of administrators moving from a submission-based benchmark to a focus on transactions; • around 20% of the benchmarks within the sample of the review were, or had recently been, in a process of cessation or transition to new administrators; and • the financial benchmarks industry is in a state of change, administrators are still working towards compliance with the principles, and a number of benchmarks are in transition to new administrators.

Appendix 2: FSB recommendations

Interest rate benchmarks

162 The following is an extract from the FSB report, *Reforming major interest rate benchmarks*:⁵⁴

Additional principles for change

Whilst each currency faces specific conditions that will determine recommendations for the appropriate reference rates, there are some general factors and criteria that should be applicable across each jurisdiction to guide the reform and transition to alternative benchmarks. These guiding principles for change should be seen as additional to the core IOSCO Principles. In developing their recommendations, authorities should work with and guide the private sector.

- The overarching objective should be to transition to rates which are anchored in transactions. More precisely, in the first instance, reference rates should be based exclusively in actual transactions. However, in many cases insufficient transactions will be available to do this and so the exact degree of dependence on transactions should vary by currency and will depend on market liquidity, depth and data sufficiency. When the conditions in the local market do not allow pure transaction rates, i.e., ones derived mechanically from transacted data without use of expert judgement, authorities should work with and guide the private sector to promote rates which are derived on a waterfall of different data types: underlying market transactions first, then transactions in related markets, then committed quotes, and then indicative quotes.
- In pursuing the objective of moving to transactions-based rates, transition risks and costs should be minimised as much as possible. These risks and costs can include legal risks arising from litigation and contract frustration and increased hedging costs resulting from reduced liquidity in instruments referencing the alternative rate or from the greater volatility that may naturally occur in more transactions-based reference rates. However, whilst risks and costs arising from legacy contracts should not be ignored, they should not be used to prevent changes regarded as necessary from a systemic perspective.
- Authorities should work with and guide the private sector to seek to ensure that any costs arising from transition are borne in a proportionate way amongst market participants and should not unduly impact the real economy.
- Public authorities have a responsibility for ensuring that the financial institutions they regulate do not use reference rates in ways that pose undue risk to the institutions themselves, to market integrity or to overall financial stability. Hence authorities should work with and guide the private sector to reduce overall risks posed by linking very large amounts of financial instruments to reference rates that they deem fragile. This notwithstanding, market participants should be able

⁵⁴ FSB, [Reforming major interest rate benchmarks](#), report, 22 July 2014, pages 12–13.

to choose among rates meeting the IOSCO Principles and use those rates in ways suited to their specific purposes so long as those uses do not pose a threat to the financial system or its integrity.

- Administrators should design benchmarks which are resilient to market stress and adaptable to varying conditions in the underlying markets.
- Finally, authorities should seek, to the extent possible, to promote international coordination in any recommendation for alternatives and transition paths. Given the international nature of capital markets, and the local nature of regulation and supervision, consideration should be given to rate reform in other jurisdictions when deciding on what changes to make in any particular jurisdiction, recognising that equivalent policy outcomes can be achieved through different legal, regulatory, or supervisory responses. In particular, work should be done to ensure that cross-currency hedging transactions are not unduly affected and that regulatory arbitrage is avoided.

FX benchmarks

163 The following is an extract from the FSB report *Foreign exchange benchmarks: Final report*.⁵⁵

Summary of recommendations

1. The group recommends the fixing window be widened from its current width of one minute. WM should determine the appropriate width in consultation with market participants. The group notes that the median suggestion from market feedback was that a five minute calculation window centred on the hour for the major (trade) currencies could be appropriate. For less liquid (non-trade) currencies, the group recommends the window be wider than for the major currencies to incorporate an adequate number of observations.
2. The group recommends that WM should incorporate price feeds and transactions data from a broader range of sources to further increase its coverage of the FX market during the fixing window, provided it is assured that the additional sources are of sufficient quality and are representative of the market. WM should regularly assess its coverage as market structure continues to evolve. In that regard the group also proposes that in the short term, WM develop its methodology to utilise the transactional and quote information from both Thomson Reuters Matching and EBS, wherever both are available.
3. WM should expand their consultation activities to include a named user group to consider the proposed changes to the calculation methodology and to ensure it remains appropriate going forward.
4. The group supports the findings of the IOSCO review of WM and endorses the recommendations for improvement contained in that review.
5. The group considers that, where central banks publish reference rates, it is the responsibility of each to set internal procedures and they should at least take note of guidance from the IOSCO principles,

⁵⁵ FSB, [Foreign exchange benchmarks: Final report](#), report, 30 September 2014, pages 3–4.

especially where central bank reference rates are intended for transaction purposes.

6. The group supports the development of industry-led initiatives to create independent netting and execution facilities for transacting fix orders.
7. The group recommends that fixing transactions be priced in a manner that is transparent and is consistent with the risk borne in accepting such transactions. This may occur via applying a bid-offer spread, as is typical in FX transactions, or through a clearly communicated and documented fee structure such as a direct fee or contractually agreed price. This should occur in the context of dealers having committed to the internal process reforms and codes of behaviour detailed below.
8. The group recommends that banks establish and enforce their internal guidelines and procedures for collecting and executing fixing orders including separate processes for handling such orders.
9. Market-makers should not share information with each other about their trading positions beyond that necessary for a transaction. This covers both individual trades, and their aggregate positions.
10. Market-makers should not pass on private information to clients or other counterparties that might enable those counterparties to anticipate the flows of other clients or counterparties, including around the fix.
11. More broadly, the group recommends that banks establish and enforce their internal systems and controls to address potential conflicts of interest arising from managing customer flow.
12. Codes of conduct that describe best practices for trading foreign exchange should detail more precisely and explicitly the extent to which information sharing between market-makers is or is not allowed. They also should, where appropriate, incorporate specific provisions on the execution of foreign exchange transactions including fixing orders.
13. The group recommends stronger demonstration by market participants of compliance with the codes of the various foreign exchange committees, as well as their internal codes of conduct.
14. The group recommends that index providers should review whether the foreign exchange fixes used in their calculation of indexes are fit for purpose.
15. The group recommends that asset managers, including those passively tracking an index, should conduct appropriate due diligence around their foreign exchange execution and be able to demonstrate that to their own clients if requested. Asset managers should also reflect the importance of selecting a reference rate that is consistent with the relevant use of that rate as they conduct such due diligence.

Based on discussions with the relevant market sectors, the group believes that all the recommendations above can and will be accepted and implemented by the market groups concerned. This should deliver a substantial improvement in market structure and conduct. But investigations into alleged misconduct are ongoing across a range of markets, and it is possible that the authorities will ultimately conclude that regulatory change is needed to promote or ensure appropriate behaviours and/or to implement the recommendations of this report.

Appendix 3: International regulatory reforms

Summary of international regulatory reforms by jurisdiction

United Kingdom

- 164 The *Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2013* (UK) came into force on 2 April 2013 and made the administration of specified benchmarks, and the providing of information in relation to a specified benchmark to a benchmark administrator, regulated activities under the Financial Services and Markets Act (UK).
- 165 Initially, the only specified benchmark was LIBOR. The Fair and Effective Markets Review subsequently recommended a list of seven additional major benchmarks across the FICC markets that should be brought into the regulatory framework. On 1 April 2015, these seven additional benchmarks were brought into the regulatory framework by the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2015 (UK):
- (a) ISDAFIX;
 - (b) Sterling Overnight Index Average (SONIA);
 - (c) Repurchase Overnight Index Average (RONIA);
 - (d) WM/Reuters London 4pm Closing Spot Rate;
 - (e) London Gold Fixing;
 - (f) LBMA Silver Price; and
 - (g) ICE Brent Index.
- 166 The regulatory regime requires benchmark administrators and submitters to be authorised by the FCA and to comply with the requirements of MAR 8.
- 167 The key requirements of a benchmark administrator are to:
- (a) appoint a benchmark administration manager;
 - (b) identify and manage conflicts of interest;
 - (c) establish an oversight committee comprised of the specified representatives;
 - (d) publish practice standards setting out its responsibilities and those of its oversight committee and the benchmark submitters;
 - (e) monitor and surveil the submissions;
 - (f) provide to the FCA on a daily basis all benchmark submissions received;
 - (g) notify the FCA of suspected manipulation of a benchmark; and

- (h) publish quarterly aggregate statistics outlining the activity in the underlying market relevant to the benchmark.

168 The key requirements of a benchmark submitter are to:

- (a) establish and maintain effective organisational and governance arrangements;
- (b) identify and manage conflicts of interest;
- (c) ensure an effective methodology for determining submissions that is reviewed at least every quarter;
- (d) keep records for a minimum of five years;
- (e) appoint an auditor on a regular basis; and
- (f) notify the FCA of suspected manipulation of a benchmark.

169 Section 91 of the Financial Services Act (UK) creates a new criminal offence of manipulation of a relevant benchmark, punishable by up to seven years imprisonment. The manipulation may occur by making a false or misleading statement in the course of arrangements for the setting of the benchmark, or by creating a false or misleading impression as to price or value that could affect the setting of the benchmark.

European Union

170 The market abuse regulation and Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (market abuse directive), published 12 June 2014, create criminal and administrative sanctions for the manipulation of benchmarks and will be directly applicable in EU member states from 3 July 2016.

171 In addition, the proposal for a new regulation on financial benchmarks, first proposed on 18 September 2013, was recently approved with amendments by the European Parliament, and is currently subject to negotiations between the European Parliament, the European Commission and the European Council. This proposal is intended to complement the sanctioning regime of the market abuse regulation and the market abuse directive by providing a regulatory framework to ensure the robustness and reliability of benchmarks.

172 The proposal is comprehensive and covers benchmarks that are made available to the public and are used to reference financial instruments which are listed or traded on a regulated venue, financial contracts (such as mortgages) in the European Union, or are used to measure the performance of an investment fund.

173 The key requirements of a benchmark administrator will be to:

- (a) obtain authorisation to provide benchmarks;

- (b) avoid or at least manage conflicts of interest;
- (c) ensure appropriate governance and controls over the benchmark-setting process;
- (d) have transparent methodologies;
- (e) publish a benchmark statement for each benchmark; and
- (f) ensure the use of sufficient, accurate and representative underlying data.

174 The proposal requires that all benchmark submitters (referred to as contributors in the proposed regulation) sign and comply with a legally-binding code of conduct drafted by the administrator specifying the administrator's and submitter's obligations. Submitters that are supervised entities (e.g. credit institutions and investment firms) are subject to additional requirements. They must:

- (a) have a control framework to ensure the integrity, accuracy and reliability of input data;
- (b) ensure that the provision of input data is not affected by any conflict of interest; and
- (c) ensure discretion is exercised independently and honestly, where required.

175 Supervision will be carried out by the national competent authorities, under the coordination of the ESMA. In the case of a critical benchmark (being a benchmark used as a reference for at least EUR500 billion of financial instruments in notional value and to which the majority of submitters are supervised entities) a supervisory college of national authorities and ESMA will be established. Critical benchmarks often have an impact in more than one EU member state and submitters are often located in different jurisdictions, requiring coordination of supervision and the exchange of information to ensure uniform authorisation and supervision.

176 Authorities will have the power to require supervised entities to contribute input data to the administrator of a critical benchmark in order to avoid the credibility of critical benchmarks being undermined by a cessation or decline in contribution levels.

Canada

177 The federal government of Canada and participating provincial securities regulators have signed an agreement to establish a Cooperative Capital Markets Regulatory System. It is planned that the Cooperative Capital Markets Regulatory System will have a common regulator, the Capital Markets Regulatory Authority.

178 In connection with the Cooperative Capital Markets Regulatory System, draft legislation was published for comment in August 2014.

- 179 The proposed *Capital Markets Stability Act* (Canada) would allow the Capital Markets Regulatory Authority to designate a benchmark as systemically important if, in the authority's opinion, impairment to the benchmark's reliability or a loss of public confidence in its integrity or credibility could pose a systemic risk to capital markets. In making an order of systemic importance, consideration would be given to, amongst other factors, the value of securities or derivatives that reference the benchmark; the number and types of persons that rely on the benchmark; the availability of substitutes for the benchmark; and the process by which the benchmark is determined.
- 180 The proposed *Capital Markets Stability Act* (Canada) gives the federal government of Canada power to make regulations that prescribe requirements, prohibitions and restrictions on systemically-important benchmarks, including in relation to:
- (a) submission of information for the purpose of determining benchmarks;
 - (b) design, determination and dissemination;
 - (c) plans for continuity, recovery and cessation;
 - (d) governance, compliance and accountability; and
 - (e) any other aspects of benchmark administration.
- 181 The proposed *Capital Markets Stability Act* (Canada) also creates two criminal offences relating to benchmarks. It would be an offence to provide another person with information for the purpose of determining a benchmark knowing that, or being reckless as to whether, the information is false or misleading. It would also be an offence to engage in conduct relating to a benchmark with the intent to produce a false or misleading determination of the benchmark. The offences would be indictable offences punishable by imprisonment for a term of not more than 10 years.⁵⁶

Japan

- 182 On 23 May 2014, an amendment to the *Financial Instruments and Exchange Act* (FIE Act) (Japan) to introduce regulation of financial benchmarks was approved by the Japanese Diet.⁵⁷ On 29 May 2015, the FIE Act (Japan) amendments, relevant Cabinet Order and Cabinet Office Ordinance were due to come into force.
- 183 The FIE Act (Japan) and the relevant rules aim to ensure the credibility of financial benchmarks that are widely used as the basis of financial transactions.

⁵⁶ A revised version of this draft legislation is expected to be released later in 2015.

⁵⁷ *2014 Amendment of Financial Instruments and Exchange Act (Act No. 44 of 2014)* (Japan).

- 184 Designated financial benchmark administrators of specified financial benchmarks (currently, only the TIBOR) are required to formulate and comply with operational rules, containing items in-line with the IOSCO Principles. The FIE Act (Japan) and the relevant rules also established an inspection and supervision framework for designated administrators and related entities.
- 185 Furthermore, the FIE Act (Japan) and the relevant rules indirectly impose discipline on submitters by requiring the designated administrators to establish a code of conduct for submitters.
- 186 The regulation exempts foreign administrators of specified financial benchmark from Japanese regulation if they are adequately supervised by the financial regulators in their home jurisdiction.

Hong Kong

- 187 The Hong Kong Monetary Authority has published a Code of Conduct for Benchmark Submitters (the second version was published on 23 August 2013) as part of its Supervisory Policy Manual. The code is a statutory guideline pursuant to section 7(3) of the Banking Ordinance (HK).
- 188 The code is intended to be of generic application to all authorised institutions (banks, restricted licence banks or deposit-taking companies) that submit rates for benchmark fixings. The two benchmark fixings to which the code currently applies are the Hong Kong Association of Banks (HKAB) HKD Interest Settlement Rate (HIBOR) and the Treasury Markets Association (TMA) CNH Hong Kong Interbank Offered Rate.
- 189 The key requirements for submitters under the code are to have adequate and effective organisational and governance arrangements, retain records relevant to the submission process for a reasonable time, implement policies for regular independent checking of submissions and relevant processes, and implement and enforce policies and procedures for handling complaints and receiving whistleblower reports.
- 190 The code also requires submitters to identify and manage conflicts of interest, including by establishing effective controls to manage conflicts of interest between the parts of the business responsible for benchmark submission and those parts who use or have an interest in the benchmark rate, and by establishing measures to prevent or limit any person from exercising inappropriate influence over the benchmark submission.
- 191 Annexed to the code are two additional codes;
- (a) Code of conduct for reference banks for HKAB's Interest Settlement Rate (HIBOR); and
 - (b) Code of conduct for reference banks for TMA's CNH Hong Kong Interbank Offered Rate.

192 These codes elaborate on the systems of control that those reference banks should put in place and provide comprehensive guidance on the rate corroboration processes.

Singapore

193 On 29 July 2014, the Monetary Authority of Singapore (MAS) released a consultation paper proposing legislation to introduce a regulatory framework for financial benchmarks. The proposed legislation consists of two key components:

- (a) The manipulation of any financial benchmark in Singapore will be made liable to criminal and civil sanctions under the *Securities and Futures Act* (Singapore). This will apply to acts of manipulation occurring within Singapore as well as in respect of financial benchmarks administered in Singapore.
- (b) Administrators and submitters of financial benchmarks designated by the MAS will be subject to regulation, including licensing requirements. The MAS will designate key financial benchmarks, based on their systemic importance and susceptibility to manipulation. The Singapore Interbank Offered Rates (SIBOR) and the Swap Offered Rates (SOR) will be designated as the key benchmarks.

Key terms

Term	Meaning in this document
ABS	Australian Bureau of Statistics
ADI	Authorised deposit-taking institution
administrator	See benchmark administrator
AFMA	Australian Financial Markets Association
AFMA Principles	AFMA, Rate contribution best practice principles (PDF 137 KB) , March 2013
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A of the Corporations Act.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act Note: This is a definition contained in s761A of the Corporations Act.
APRA	Australian Prudential Regulation Authority
APX	Asia Pacific Exchange Limited or the exchange market operated by APX Limited
ASIC Act	<i>Australian Securities and Investments Commission Act 2001</i>
ASX	ASX Limited or the exchange market operated by ASX Limited
ASX Limited	The market licensee that operates the exchange market known as 'ASX'
benchmark	See financial benchmark
benchmark administrator	An entity that has responsibility for the calculation of the benchmark, determining and applying the benchmark methodology and disseminating the benchmark
BIS	Bank for International Settlements
BBSW	Bank Bill Swap Rate
Chi-X	Chi-X Australia Pty Limited or the exchange market operated by Chi-X
CFTC	Commodities Futures Trading Commission (US)
CGS	Commonwealth Government Securities
Corporations Act	<i>Corporations Act 2001</i>

Term	Meaning in this document
CPI	Consumer Price Index
ECB	European Central Bank
enforceable undertaking	An enforceable undertaking that may be accepted by ASIC under s93AA of the ASIC Act
ESMA	European Securities and Markets Authority
ETF	Exchange-traded fund
Euribor	Euro Interbank Offered Rate
Fair and Effective Markets Review	A review of the wholesale FICC markets led by the Bank of England and co-chaired by the FCA and HM Treasury
FCA	Financial Conduct Authority (UK)
FICC markets	Fixed income, currency and commodity markets
financial benchmark	A price, estimate, rate, index or value calculated from a representative set of underlying data or information and used as a reference or measure in financial instruments and financial markets, other than prices of individual securities to constitute benchmarks
financial market	As defined in s767A of the Corporations Act, a facility through which offers to acquire or dispose of financial products are regularly made or accepted
FSB	Financial Stability Board
FX	Foreign exchange
GFMA	Global Financial Markets Association
GFMA Principles	GFMA, Principles for financial benchmarks , 30 November 2012
HKAB	Hong Kong Association of Banks
ICE	Intercontinental Exchange
IOSCO	International Organization of Securities Commissions
IOSCO Principles	IOSCO, Principles for financial benchmarks: Final report (PDF 389 KB) , 17 July 2013
LIBOR	London Interbank Offered Rate
LBMA	London Bullion Market Association
market integrity rules	Rules made by ASIC, under s798G of the Corporations Act, for trading on domestic licensed markets
MAR 8	Chapter 8 of the FCA Handbook of Rules and Guidance

Term	Meaning in this document
MAS	Monetary Authority of Singapore
OTC	Over the counter
RBA	Reserve Bank of Australia
Shared Global Principles	Australian Foreign Exchange Committee, Global preamble: Codes of best market practice and shared global principles (PDF 88 KB) , March 2015
submitter	A market participant or other entity that submits information to a benchmark administrator in connection with the determination of a benchmark. A submitter can also be an individual employee(s) with responsibility for determining the submission and submitting it to the benchmark administrator
TIBOR	Tokyo Interbank Offered Rate
TMA	Treasury Markets Association (Hong Kong)
WM	The World Markets Company

Related information

Headnotes

administrator, ASIC Act, Bank Bill Swap rate, BBSW, benchmark administrator, benchmark submitter, conduct risk, Corporations Act, enforceable undertaking, financial benchmarks, Financial Stability Board, FSB, foreign exchange, FX, interest rate benchmark, International Organization of Securities Commissions, IOSCO, market abuse, market conduct, market confidence, market manipulation, submitter

Legislation

Corporations Act

Australian Securities and Investments Commission Act

Anti-Money Laundering and Counter-Terrorism Financing Act 2006

Financial Transaction Reports Act 1988

Market Integrity Rules

ASIC Market Integrity Rules (ASX Market) 2010

ASIC Market Integrity Rules (Chi-X Australia Market) 2011

ASIC Market Integrity Rules (APX Market) 2013

Media releases

13-366MR *ASIC accepts enforceable undertaking from UBS*

14-014MR *ASIC accepts enforceable undertaking from BNP Paribas*

14-169MR *ASIC accepts enforceable undertaking from The Royal Bank of Scotland*

15-177MR *ASIC Reports on financial benchmarks*