

**STOXX Ltd.**

**Response  
to  
Public Consultation**

by the

European Securities and Markets Authority and  
the European Banking Authority

on

“Principles for Benchmark-Setting Processes in the EU”

Zurich, 8 February 2013

Contents

1. Overview on STOXX .....2
2. General Feedback and Introduction .....2
3. Concrete Answers to the Questions .....5
Appendix: STOXX Response to the EU COMM consultation .....9

1. OVERVIEW ON STOXX

STOXX is pleased to have the opportunity to submit comments to the European Securities and Markets Authority and to the European Banking Authority in response to their “Consultation Paper – Principles for the Benchmarks-Setting Processes in the EU”.

STOXX Limited is an established index specialist with a European heritage. The launch of the first STOXX® indices in 1998, including the EURO STOXX 50® index, marked the beginning of the STOXX business activities. Since that time, STOXX has been continuously expanding its portfolio of indices, and now operates on a global level, across all asset classes. STOXX Limited is committed to delivering its high-quality, reliable and trusted index offerings to its global client base.

Our indices are licensed to the world's largest issuers of financial products, capital owners and asset managers, in total to more than 400 companies around the world, and are used not only as underlyings for financial products such as exchange-traded funds (ETFs), futures and options, and structured products, but also for risk and performance measurement.

Indices fulfill a number of important roles in the financial markets. However, indices in general have come under increased scrutiny despite the fact that the alleged manipulation of LIBOR was related to a specific panel-based index with intransparent and subjective pricing sources. We agree that neutral and unbiased market information is key for a functioning capital market. Thus we fully support efforts to strengthen the robustness and integrity of panel-based indices, where those panels are prone to significant conflict of interest, provided in the context of offering financial products.

We would welcome the opportunity to discuss the content of our submission with you further. Should you require any additional information in the meantime, please contact: Dr. Hartmut Graf; CEO; STOXX Ltd.; Selnaustrasse 30; 8021 Zurich; Switzerland; Hartmut.Graf@stox.com.

We are happy for our comments to be made public.

2. GENERAL FEEDBACK AND INTRODUCTION

STOXX supports initiatives that address concerns about panel-based indices, where those panels are prone to significant conflict of interest, and also welcomes policy orientations for this specific class of indices ahead of any formal legislative framework which may follow.

A wider range of initiatives had been initiated to explore policy orientations for indices and benchmarks in general. We understand from the current discussions the need to explore the necessity for directives and general principles for all types of indices. However, we strongly recommend taking ad hoc measures and guidelines only in the area of panel-based indices where immediate action is indeed required against the background of alleged LIBOR misconduct. We do not think there is a need for a broader regulation of

indices in general – and specifically not for certain "Objective Indices"<sup>1</sup>. Before you conclude your own thorough evaluation, we strongly recommend that you wait with for the outcome of the numerous consultation processes on European and global level, in order not to potentially prejudge these efforts with interim guidelines where no immediate action is required, as any guidelines or principles have the potential to change market structures and may massively impact the business activities of index providers. –The legislative process initiated by the European Commission ("EU COMM")<sup>2</sup> and the consultation by The Board of the International Organization of Securities Commissions on Financial Benchmarks ("IOSCO")<sup>3</sup> currently already deal with benchmarks in a broad and comprehensive context.

**We therefore conclude that any ad hoc or interim guidelines issued by ESMA/EBA should be limited to panel-based indices only. We suggest the discussion of potential regulatory guidelines for all further types of indices in broader and global processes as currently already initiated by EU COMM and IOSCO. This approach enables the short-term closure of regulatory gaps which became required in the context of the LIBOR manipulation and ensures that all further regulation is undertaken after a detailed analysis.**

For the purpose of this document we define the term "index" as follows:

An "**index**" is an aggregation of market data of financial instruments or acquirable assets which are used either as a basis for financial products ("underlying") or to evaluate financial investments ("benchmark").

Although provision of information was the primary reason for establishing the first indices, today's prominent and well-known indices usually fulfill three main purposes often simultaneously:

- » As a "**benchmark**" against which to assess the performance of a given or hypothetical financial investment.
- » Fulfilling an "**underlying**" function, in which the index provides a reference price for tradable investment products such as exchange traded funds ("ETFs"), structured products, or derivatives.
- » Providing aggregated **information** to the public and investors on certain markets as a whole or on certain market segments as a means of supportive information on economic development.

In contrast, in the Consultation Paper the following definition was provided:

**Benchmark:** *Any commercial index or published figure, including those accessible on the internet whether free of charge or not,*

- a) *calculated entirely or partially by the application of a formula to or an assessment of the value of one or more underlying assets, prices or certain other data, including estimated prices, interest rates or other values, or surveys;*
- b) *by reference to which the amount payable under a financial instrument or the value of the financial instrument is determined.*

The terminology used by us above deviates from the proposed definitions by ESMA/EBA for the following reasons:

- » Limitation of scope: We consider only aggregations of market data of financial instruments or acquirable assets as the appropriate basis for indices, not also as proposed "Any [...] published

<sup>1</sup> **Objective Indices** fulfill a clear set of criteria, i.e. possibility of full replication, high quality data usage, adequate methodology, inherent integrity, continuous quality controls, high availability and appropriate governance; indices which do not fulfill at least one of these criteria above are categorized as **Subjective Indices**; please refer to the appendix for a more detailed explanation

<sup>2</sup> European Commission; Consultation Document on the Regulation of Indices (5.9.2012)

<sup>3</sup> The Board of the International Organization of Securities Commissions; Financial Benchmarks – Consultation Report (January 2013)

figure" which calculation is based on "[...] certain other data". Pure numerical and statistical figures therefore do not and should not qualify as an index according to our definition.

- » Clarifications of usage: As both "benchmarking" and "underlyings" are commonly applied terms for specific types of usage, we establish "index" as the master term.

Indices differ widely in their methodology and calculation. A narrow subgroup are the so called "**panel-based indices**" usually composed of rather few constituents which are priced by submissions of panel members. Often certain elements for pricing of the constituents and/or calculation are intransparent and submitters of prices are at the same time users of these panel-based indices in financial products, i.e. they trade and invest into index-based financial products and determine the value of the underlying index in the first place. In this respect, the LIBOR is the most discussed example for this narrow group of indices.

A more granular discussion and introduction can be found in the "STOXX' Response to the European Commission Consultation Paper on the Regulation of Indices", attached as an appendix to this response.

However, **pure macroeconomic indicators** beyond those published by governmental agencies describing the state of an economy are excluded from the definition of the term "index" above as they are not directly tied to any financial instrument, and are usually only used to achieve a clearer picture of the current economic environment. Furthermore, there are **no conflicts of interest involved in the creation and usage of those indicators which could lead to the unreliability or bias of those indicators.**

Those indices/indicators can be identified as pure information indicators, although the calculation of such an indicator can resemble those of a benchmark from a pure technical point of view.

There are in principle no restrictions to providing indices to the market place and as a result a broader group of providers develops and maintains indices in a competitive environment. However, we believe that one group in particular is dedicated to providing high quality indices and we define these as **neutral index providers**: separate organizational units with the primary objective of developing, calculating, maintaining, and marketing indices on a commercial basis to market participants without maintaining any own position in these indices. Those neutral index providers are in particular independent from market participants (who trade index related products or invest into index related products).

By running the provision of indices as a separate for profit business, neutral index providers have certain specific characteristics:

- » They do not have conflict of interests;
- » They are committed to achieve highest quality;
- » They serve the entire market and therefore offer indices on an unbiased basis to any specific user group.
- » They have built significant experience and have continuously developed indices further funded by their independent business activities.
- » They own a wider range of property rights in their indices.

A more granular discussion of the key elements forming neutral index providers and respective benefits for the market place can be found in the appendix to this document.

### 3. CONCRETE ANSWERS TO THE QUESTIONS

Questions	Answers
<p><b>Question 1: Definition of the activities of benchmark setting</b> Do you agree with the definitions provided in this section? Is this list of activities complete and accurate?</p>	<p>Although the given definitions for the value chain in the index business are widely accepted, certain other definitions in the Consultation Paper are potentially too broad and too less concrete. We therefore propose to use the terms “<b>index</b>”, “<b>benchmark</b>” and “<b>underlying</b>” as defined in section 2, “<i>General Feedback and Introduction</i>” above.</p> <p>Also, as outlined in the introductory paragraph, <b>pure macroeconomic indicators</b> beyond those provided by governmental agencies are excluded from the definitions proposed by ESMA/EBA and should not be in the focus of this consultation, as they are usually not directly tied to any financial instrument, not prone to any conflict of interest and usually only complement macroeconomic indicators published by governmental agencies.</p> <p>Please note that certain definitions given in the Consultation Paper only work in the context of panel-based indices and would create confusion if applied to indices in general. The term “contributing firm” belongs to this category, which becomes unclear for its meaning when thinking about trades executed on regulated exchanges and other regulated trading platforms. As outlined in the introduction, we argue that regulation on an ad hoc basis is only required for the narrow subgroup of panel-based indices.</p>
<p><b>Question 2: Principles for benchmarks</b> Would you consider a set of principles a useful framework for guiding benchmark setting activities until a possible formal regulatory and supervisory framework has been established in the EU?</p>	<p>As outlined in the introduction, certain principles might be established for LIBOR-type indices for an interim period until the final new legal framework is approved. However, we would like to suggest that these principles <b>should not</b> be drafted and applied to <b>all</b> types of indices but only to the narrow subgroup of panel-based indices. Otherwise potentially significant implications on index providers, market participants and the overall functioning of the markets may occur. We therefore strongly recommend waiting for the outcome of the numerous consultation processes on European and global level in order not to potentially prejudice these efforts.</p>
<p><b>Question 3: General principles for benchmarks</b> Do you agree with the principles cited in this section? Would you add or change any of the principles?</p>	<p>As outlined in the introduction, some panel-based indices like LIBOR, where inherent conflicts of interest exist, may lack sufficient scrutiny and at least some general principles might be required ad hoc to be implemented as interim protective measures for this narrow group of indices only. However, some of the principles outlined in the Consultation Paper are ambiguous and could be misinterpreted in a way that violates certain IP rights and other proprietary rights of the index providers which are the fundamental basis of their business. It is urgently recommended to have a more detailed discussion in particular about the required level of transparency in the current in-depth legislative process by EU COMM or the broader initiative of IOSCO only.</p> <p>While STOXX acknowledges the importance of transparency for investors (which neutral index providers already today apply by disclosing the full information to their clients to replicate an index), we would like to encourage ESMA/EBA to fully take into account the importance of IP protection. Although certain data are and should be freely available, when it comes to the core of IP-protected information, index providers need to be free to decide which data they want to publish as this is crucial for them to generate a return on their investments and to be protected against free-riding competitors copying their products.</p>

**Questions****Answers**

In addition, although the principles could be clearly defined for LIBOR-type, panel-based indices with data submissions by users, these principles may not be adequate and reasonable measures for the broader range of indices and benchmarks in general. For example, the proposed balancing between the confidentiality rights of data providers with transparency requirements in general is problematic for the broader range of indices as protection of the respective IP rights and other proprietary rights should outweigh any general publication demand.

Furthermore the manipulation of benchmarks is already covered by the recently amended proposals for a Regulation on insider dealing and market manipulation (market abuse) and a Directive on criminal sanctions on insider dealing and market manipulation<sup>4</sup>.

**Question 4: Principles for firms involved in benchmark data submissions**

Do you agree with the principles cited in this section? Would you add or change any of the principles?

Furthermore, we consider the supporting principles defined by ESMA as providing value in a panel-based data generating process similar to the one applied for LIBOR. The conflict of interests existing in this process between those entities submitting data (non- transactions data with a certain degree of freedom as regards the submitted values) and the application of the benchmark (based on the submitted data) in profit generating way for the same entity. However, an application of those principles to any panel-based data generating process, regardless of a potentially existing conflict of interest, would result in a regulatory overkill.

**Question 5: Principles for benchmark administrators**

Do you agree with the principles cited in this section? Would you add or change any of the principles?

We share ESMA's view that panel-based benchmarks (such as the LIBOR) as currently provided to the market may lack sufficient governance procedures.

However, as outlined in the introductory paragraph, neutral index providers have implemented a broad range of governance and operational structures. This is in their own interest as this is one important means to serve the market with high quality products in an unbiased way. Effective global competition enforces high scrutiny for superior standards in product related governance and operations. Due to the global nature of their businesses and the effective competition in this market we would argue strongly for a detailed evaluation of the extent to which it is necessary to set reasonable standards regarding the governance structures and organizational procedures for providers of Objective Indices *before* applying "one size fits all" regulation based on the recent problems with panel-based indices. In addition, certain proposed principles may violate certain property rights of index providers and should therefore not be implemented. ESMA itself requires only a delayed publication of index constituents in its recently issued guidelines on UCITS.

Publication of information about the indices (e.g. the methodology) is a widely adopted market practice and required by the clients. Indeed sufficient disclosure towards clients is a prerequisite to run indexing as a business. However, the extent to which information is shared publicly should be at the discretion of the index provider as this impacts the business model and activities of index providers fundamentally.

<sup>4</sup> E.g. Report on the proposal for a regulation of the European Parliament and of the Council on insider dealing and market manipulations (market abuse) (COM(2011)0651 – C7-0360/2011 – 2011/0295(COD))

Questions	Answers
<p><b>Question 6: Principles for benchmark calculation agents</b> Do you agree with the principles cited in this section? Would you add or change any of the principles?</p>	<p>Calculation of indices and benchmarks was mainly undistorted in history over decades and thus we would argue that any potential guideline for calculators should be part of the broader legislative processes of the EU COMM or of the global IOSCO initiative.</p>
<p><b>Question 7: Principles for benchmark publishers</b> Do you agree with the principles cited in this section? Would you add or change any of the principles?</p>	<p>Publication of indices and benchmarks currently takes place in a variety of different ways and is continuously adjusted to market demands. Index or benchmark publication was mainly undistorted in the past and thus we would argue that any potential guideline for publishers should be part of the broader legislative processes of the EU COMM or of the global IOSCO initiative.</p> <p>We also generally agree with the supporting principles suggested by ESMA as regards the accountabilities and responsibilities for benchmark calculation at the benchmark publisher. However, for the avoidance of doubt, we would like to point out that the responsibilities <b>should be clearly defined within the respective company but that no publication of those details would be necessary.</b></p> <p>We agree as well that the benchmark publisher should implement and maintain adequate systems for the consistent and timely benchmark publication governed by <b>contractual arrangements</b> with the index administrator.</p>
<p><b>Question 8: Principles for users of benchmarks</b> Do you agree with the principles cited in this section? Would you add or change any of the principles?</p>	<p>Any regulation should take into consideration and not distort the balance between index providers and index users.</p>
<p><b>Question 9: Practical application of the principles</b> Are there any areas of benchmarks for which the above principles would be inadequate? If so, please provide details on the relevant benchmarks and the reasons of inadequacy.</p>	<p>We stated in our introduction above that we may understand the need to take immediate action with regard to some panel-based benchmarks like the LIBOR.</p> <p>However, we also argued in detail that regulating the complete range of indices may require in-depth scrutiny and should only be done with sufficient care and after appropriate evaluation. As there is currently an in-depth legislative process by the EU COMM underway, we deem it more appropriate to deal with a broad regulation in that context only.</p> <p>Furthermore, for <b>pure macroeconomic indicators</b> the principles detailed by ESMA would present regulatory overkill as those indicators are usually not directly tied to any financial instrument, not prone to any conflict of interest and usually only complement macroeconomic indicators already published by governmental agencies.</p>

---

**Questions****Answers****Question 10: Continuity of benchmarks**

Which principles/criteria would you consider necessary to be established for the continuity of benchmarks in case of a change to the framework?

It has been proven in the past<sup>5</sup> that both a significant early announcement and – in the case of larger adjustments – a staggered execution are good means to implement larger changes with minimal distortion.

---

<sup>5</sup> See for example: [http://www.msci.com/eqb/pressreleases/archive/20001210\\_pr01.pdf](http://www.msci.com/eqb/pressreleases/archive/20001210_pr01.pdf)

---

## APPENDIX: STOXX RESPONSE TO THE EU COMM CONSULTATION

### 1. INTRODUCTION

*The function of financial indices is not limited to their direct use in the financial products markets only: they fulfill other important roles in the overall macro-economic environment:*

- » *Only with proper and reliable indices is a rational, efficient and transparent global capital allocation possible for financial investors. Efficient capital allocation minimizes the capital costs for companies and thus spurs global economic growth.*
- » *Indices allow companies with global business activities an easy and transparent macro-hedging of their business exposure to certain countries, regions or industry sectors.*
- » *Indices (through financial products issued on them) enable a broader range of investors, including retail investors, to access entire markets and advanced asset allocation strategies. They can hereby diversify their investments and thus reduce their investment risk.*

*Although provision of information was the primary reason for establishing the first indices, today's prominent and well-known indices usually fulfill three main purposes often simultaneously:*

- » *As a source of information or as a "**benchmark**" against which to assess the performance of a given or hypothetical financial investment.*
- » *Fulfilling an "**underlying**" function, in which the index provides a reference price for tradable investment products such as exchange traded funds ("ETFs"), structured products, or derivatives.*
- » *Providing aggregated **information** to the public and investors on certain markets as a whole or on certain market segments as a means of supportive information on economic development.*

#### 1.1. DEFINITIONS AND GENERAL VIEWS

##### 1.1.1. DEFINITION OF AN "INDEX"

*The term "index" as used here shall have the following meaning:*

*An "**index**" is an aggregation of market data of financial instruments or acquirable assets which are used either as a basis for financial products ("underlying") or to evaluate financial investments ("benchmark").*

*The key element of our definition is the foundation of indices on either market data of financial instruments or acquirable assets. This relationship allows the index to be fully replicated by directly investing in the respective financial instruments or acquirable assets. Thus, only those concepts where full direct replication is possible qualify as an index. The second constitutive element of indices is their usage in the financial services industry. Again, we consider only those statistical figures composed of market data as indices, which are used for the specific purposes of being an underlying or a benchmark.*

*This definition is largely aligned with the definition proposed by the Commission:*

"Benchmark" means any commercial index or published figure calculated by the application of a formula to the value of one or more underlying assets or prices, including estimated prices, interest rates or other values, or surveys by reference to which the amount payable under a financial instrument is determined."

In both cases the specific ingoing data are the constituting element of the definition, i.e. the "indices"/ "benchmarks" are based on assets which could be clearly valued. However, we also deem it appropriate in our definition to define the nature of such assets more specifically as financial instruments. Only then is it possible to directly replicate the index by directly acquiring exactly those assets the index is composed of. This is highly advantageous, as only in this case could exposure to the index be fully hedged without additional risks.

All other aggregations of market data or statistical figures will be referred to as "**other informational instruments**". Those other informational instruments are made up of any data except from financial instruments, e.g. industry or corporate news. This is a continuously growing field as the financial markets' information sources become more and more complex, but will not be considered in our response here.

The table below shows the difference between "indices" and "other informational instruments" in terms of their:

- » **Main purpose:** What are the indices used for? Do the indices have a direct link to the financial markets? Could the index portfolio be fully replicated by financial products?
- » **Data quality:** How transparent are the ingoing data? Are the data objective or subjective? How timely are the data?
- » **Methodology:** Is the index calculation transparent? Does it contain fees? Does the calculation contain discretionary elements? Is the index calculation continuous?

<b>Main purpose</b>	<b>Data quality</b>		<b>Methodology</b>	<b>Examples</b>	<b>Category</b>
Financial (underlying or benchmark)	Liquid, traded prices, firm quotes	<b>AND</b>	Fully rules-based and transparent; continuous calculation	EURO STOXX 50	<b>Objective indices</b>
Financial (underlying or benchmark)	Unregulated and indicative quotes, estimates, etc.	<b>AND/ OR</b>	Discretionary elements predominant; not entirely representative	LIBOR	<b>Subjective indices</b>
Informational	Any source other than prices for financial instruments (either transparent, regulated or unregulated, indicative)	<b>AND</b>	Any methodology	Consumer sentiment index; unemployment rates	<b>Other informational instruments</b>

For clarification, please note that objective indices need to fulfill both the criteria for data quality and for methodology simultaneously.

## 1.1.2. DIFFERENTIATION BETWEEN OBJECTIVE INDICES AND SUBJECTIVE INDICES

The broad range of figures used as underlyings and benchmarks differ widely depending on their principles of construction, maintenance and objectivity. As a result indices can be broken down into two distinct categories: objective and subjective indices.

**Objective indices** fulfill a clear set of criteria (simultaneously) as follows:

- » **Possibility of full replication:** the index should be fully replicable by existing financial instruments without significant tracking errors. This requires that the same performance of the index could be obtained by acquiring all index components according to the methodology of the index.
- » **High quality data:** One prerequisite for full replication is the use of either traded prices of liquid instruments or prices from firm quotes from a regulated trading venue (without conflicts of interest), which are fully executable at any time. This is required to ensure that market participants can actually adjust their portfolios at the price levels used in the index at all times. The price source for the index should come from the price determining venue and – in case this is not biunique – have sufficient liquidity in the corresponding asset. Only those prices which provide indiscriminate access to all market participants, and without distortions, should be used. For certain indices there might be added value in having all prices from one venue in order to determine high quality and highly liquid settlement prices based on the same methodology and homogenous data quality and standards.
- » **Adequate methodology:** It is of paramount importance to have a fully rules-based methodology that is published in a completely transparent rule book. Discretionary elements should not be part of the methodology. This methodology should reflect the relevant market or the relevant strategy accordingly and with the required level of sophistication. In addition, the methodology should cover an appropriate checking of ingoing and outgoing data to avoid the inclusion of any mispricing. Furthermore, a continuous index calculation hinders exercise of influence on the index values as a potential manipulation might need to occur over a longer time period.
- » **Inherent integrity:** The index methodology and calculation should be free of conflicts of interest and guarantee a clear split between the providers of indices, the sources of pricing for the instruments in the index and parties being (directly or indirectly) economically exposed to the resulting index values. The following cases might require special consideration:
  - » If the pricing sources and the provider of indices are related, the prices should be sourced from regulated trading venues only.
  - » Trading and investing in indices while in parallel providing prices for the index calculation would violate the required integrity.
- » **Continuous quality controls:** The inbound and outbound information should be filtered according to the methodology. Similarly the resulting index values should be filtered or flagged. In addition, index calculations should be monitored at all times.
- » **High availability:** Given their importance as underlyings, objective indices need to be available to professional investors and product providers. Systems used to provide index values should follow the highest technical standards including fail-over hot-stand-by technology.
- » **Appropriate governance:** Only fully rules-based indices fall under the definition of objective indices. However, as markets are evolving and external factors change over time, a process needs to be in place to adjust the rules, and this could involve independent advisory boards and appropriate publication mechanisms for the changes.

By contrast, all indices which do not fulfill at least one of the criteria above are categorized as **subjective indices**.

The table below shows a detailed comparison of objective and subjective indices.

<b>Category</b>	<b>Subjective indices</b>		<b>Objective indices</b>
<b>Classification</b>	» <i>Artificial indices</i>	» <i>"LIBOR"-like</i>	» <i>"EURO STOXX 50"-like</i>
<b>Examples</b>	» <i>Hedge fund indices based on intransparent prices from inhouse platforms</i>	» <i>LIBOR</i> » <i>Fixed income indices based on indicative quotes</i>	» <i>EURO STOXX 50</i>
<b>Replicability</b>	» <i>Not directly replicable</i>	» <i>Not directly replicable, approximate replication possible</i>	» <i>Directly replicable</i>

**Data quality**

» <i>Inbound price sources</i>	» <i>Non-transparent sources, e.g. inhouse and non-publicly available prices used by self-indexers</i>	» <i>Indicative panel consultation</i> » <i>No obligations attached to price submission</i>	» <i>Transaction based prices from regulated market venues</i> » <i>Prices based on binding and regulated transactions or quotes</i>
» <i>Calculation parameters</i>	» <i>No further transparency on additional information used for index calculation</i> » <i>Examples might include in-house determined transaction fees</i>	» <i>(Similar to objective indices)</i>	» <i>All further information used taken from publicly available sources and both with ex-post and ex-ante transparency</i>
<b>Methodology</b>			
» <i>Index methodology</i>	» <i>Anything less than for the “LIBOR-like” indices; in particular</i> » <i>Incomplete methodology with room for massive discretionary interactions</i>	» <i>Anything less than for the “EURO STOXX 50-like” indices, in particular:</i> » <i>Discretionary elements</i> » <i>Simple calculation methods</i> » <i>Unavailability of filters</i>	» <i>Fully rule-based concepts</i> » <i>No discretionary elements in methodology on ordinary index adjustments and clear governance rules for any extraordinary event</i> » <i>No fee elements included (with the exception of fees for replication)</i> » <i>Application of filters to ensure data quality</i>
» <i>Publication of rule books</i>	» <i>Not published or not published completely</i> » <i>Not freely accessible</i>	» <i>Published completely</i> » <i>Freely accessible</i>	» <i>Published completely</i> » <i>Freely accessible</i> » <i>Replication of the target market or strategy are stated aims</i>
<b>Inherent integrity</b>			
	» <i>Combination of index provider, user (issuer) and price provider</i>	» <i>Combination of user (issuer) and price provider</i>	» <i>Clear (organizational) split between index provider and user (issuer) – or even no link</i> » <i>Independent price sources</i> » <i>No conflicts of interest</i>
<b>Quality controls</b>			
	» <i>None</i>	» <i>None</i>	» <i>Extensive in- and outbound filtering</i>
<b>Governance</b>			
	» <i>None</i>	» <i>None</i>	» <i>Independent advisory boards</i>
<b>Availability</b>			
	» <i>Not guaranteed</i>	» <i>?</i>	» <i>Ensured</i>

*Requirements of objective indices:*

- Full replicability	<i>y</i>	<i>y</i>	<i>p</i>
- High data quality	<i>y</i>	<i>y</i>	<i>p</i>
- Adequate methodology			
- Inherent integrity	<i>y</i>	<i>p</i>	<i>p</i>
- Continuous quality control	<i>y</i>	<i>y</i>	<i>p</i>
- High availability	<i>y</i>	<i>py</i>	<i>p</i>
	<i>y</i>	<i>py</i>	<i>p</i>

## 1.1.3. THE IMPORTANCE OF INHERENT INTEGRITY

As outlined above, certain index providers do, by their specific set-up and focus, guarantee safeguards for index maintenance. This is particularly true where the provider or any associated affiliate does not benefit directly from the provided index levels. Indeed any form of manipulation of their indices would endanger the trust in its products which is a key asset for independent index providers. The indices of independent index providers such as STOXX are and have to be of high quality, produced without conflicts of interests and of the strictest neutrality to all market participants, otherwise the index provider would lose its reputation and therefore its customers.

In contrast, the absence of this split between provider of prices/provider of indices and the economic beneficiary of the index levels was a key issue in the LIBOR case.

## 1.1.4. THE IMPORTANCE OF INGOING DATA

As is clear from the table above, indices differ according to the type of ingoing data being used. In principle, there are three different types to distinguish:

- » Publicly available **traded prices or firm quotes** sourced from a liquid and regulated market. Traded prices from a regulated market do not require explicit explanations. A relevant example would be equity indices like the EURO STOXX 50 being calculated with the traded prices from the leading local regulated exchanges in Europe. Firm quotes from regulated markets are defined as being executable at all times. An example of the usage of firm quotes is the process for including new components in the eb.rexx fixed income indices, where binding ask prices from the regulated Eurex Bonds platform are used.

- » Any other **indicative pricing** which could be non-firm quotes or estimates obtained systematically or randomly. An example would be the LIBOR. However, indices for market segments currently dominated by off-exchange trading resulting in non-transparent pricings also fall into this category. One prominent example would be many fixed income indices (if they are not based on traded prices).
- » **Any other data** may also be used as a basis for the other informational instruments. Those figures might be obtained by surveys, statistical census or individual measurements. Examples here are unemployment rates, inflation rates or consumer sentiment data. In principle, there is no limitation for any such figures.

## 1.2. RELEVANCE OF THE EXISTING LEGAL FRAMEWORK

*Index providers and data providers (that are their sources of data for the purpose of index calculations) do not operate in an unregulated environment. On the one hand, there are the UCITS regulations that require entirely rules-based indices. On the other hand, index providers have multiple intellectual property rights which need to be considered in this context as well.*

### 1.2.1. UCITS REQUIRES RULES-BASED INDICES

*According to Article 53 of the UCITS IV Directive (2009/65/EC), an eligible index for UCITS needs to be sufficiently diversified with respect to its composition; the index needs to represent an adequate benchmark for the market to which it refers; and it needs to be published in an appropriate manner. The Eligible Assets Directive (2007/16/EC) defines the aforementioned criteria in more detail. In particular, Article 9 sets out that the index measures the performance of a representative group of underlyings in a relevant and appropriate way.*

*In addition, financial indices must reflect their corresponding markets following transparent and publicly available criteria and must be based on sufficiently liquid underlyings. The ESMA Guidelines contain more detailed provisions. Amongst others, paragraph 54 sets out that a UCITS should only invest in financial indices whose methodology is based on a set of pre-determined and objective criteria. In other words, these rules do not allow for discretionary decisions of an index provider which would leave room for manipulations.*

*If an index provider wants to market its products broadly, then it must make sure that its indices comply with these rules in order to be eligible as underlying for financial products that are marketed under UCITS.*

### 1.2.2. INDICES ARE PROTECTED BY LAW

*Indices are subject to multiple intellectual property rights, including, but not limited to copyrights, data base protection rights, trademark rights etc. and thus do not qualify as a "public good". The European Commission and also the G8 governments have put much effort into promoting their knowledge-based economies through strengthening intellectual property rights (see for example the respective G8 statement at <http://www.whitehouse.gov/the-press-office/2012/05/19/statement-g-8-leaders-global-economy>).*

## 1.3. NEUTRAL INDEX PROVIDERS

*There are in principle no obstacles to providing indices to the market place and as a result a broader group of providers develops and maintains indices. However, we believe that one group in particular is*

dedicated to providing high quality indices and we define these as **neutral index providers**: separate organizational units with the primary objective of developing, calculating, maintaining, and marketing indices for profit to organizationally un-related third parties. Those neutral index providers are in particular independent from market participants (who trade index related products or invest into index related products).

For clarification, providers who

- » predominantly provide indices for the use of organizationally-related units or issuers of products (which benefit from the value of the indices); or
- » predominantly calculate and maintain indices on behalf of one specific market participant only would not satisfy our definition above and are therefore not considered as neutral index providers. The main criteria are that the neutral index providers generate income from licensing their indices and **do not benefit from the value of the indices they provide**. For the avoidance of doubt, infrastructure providers who only enable trading or investing by providing technical platforms have no economic relationship to the index performance and are thus not included in the definition of the market participants above.

Any potential limiting of the activities of neutral index providers may bring undesired costs and potential negative impacts on the market place which would be undesirable for the following reasons:

1. Neutral index providers do **not have conflicts of interest** such as providing information for the index calculation and indirectly benefitting from specific index values.
  - » All index methodology and calculation related decisions are taken independently by the index provider without any direct influence being granted to clients or other third parties
  - » In addition neutral index providers do not generate revenues from index membership fees, also ensuring independence in the selection of the components of an index
 Only neutral index providers will **guarantee unbiased indices** (like the objective indices defined above).

In the absence of neutral index providers the issuers of financial products will rely exclusively on indices from associated parties provided for their own usage only. **Less competition in the products market** will occur as a consequence, as the products in the market will no longer be directly comparable for the end investor – at least not without a significant amount of sophisticated research.

Subsequently more differently priced but rather undistinguishable products will appear without the possibility of comparison of concept and pricing. This will harm end investors by reducing their possibilities for un-biased tools for a broader diversification, and thus risk reduction, as well as reducing market transparency. In addition, broader licensing of those proprietary concepts by product sponsors does not currently exist and will not exist in the future. In consequence, those indices will be used predominantly for the purpose of one specific product sponsor and not for the benefit of end investors.

2. Neutral index **providers are committed, out of their own business interest, to achieving the highest quality of index calculation** and maintenance; only a for-profit index business allows the **participation** of the entire market including the retail market **in state-of-the-art innovations**.
  - » As their main nature of business is the provision of indices, neutral index providers continuously improve their operational processes to preserve their competitive position.
  - » Only by having the opportunity to materialize the benefits of innovation will new concepts be made widely available.

If the monetization of neutral index providers' products / indices were restricted, the overall **dynamics of innovation might decrease**.

3. *Neutral index providers, by nature of their business models, **serve the entire market** and are therefore best suited to **offer indices unbiased** towards any specific user group.*
- » *Neutral index providers offer their services to both sides of the market: the issuers of financial products ("sell-side") as well as to asset managers and asset owners ("buy-side").*
  - » *Any adjustment of the indices must be suitable for all market participants simultaneously (and not only to the benefit of product issuers).*
  - » *Partial restriction of activities would potentially lead to a segmented and biased group of providers, each serving a limited range of market participants only. As realization of economic benefit is limited to a smaller group only, homogeneity and uniformity of indices might be the unintended result. As this might not become completely transparent, **less sophisticated or less influential investors may suffer** from being pulled into potentially one-sided products.*
4. *Neutral index providers **have built up significant experience** of index calculation without causing any distortions.*
- » *Index provision from the neutral index providers is driven by high performance requirements as one of the key competitive criteria.*
  - » *The wider usage of indices as underlyings has driven index providers to continuously develop highly sophisticated methods for quality checking both inbound and outbound data.*
  - » *If the market structures change significantly, the **know-how and experience** of neutral index provider **may shrink**.*
5. *As mentioned above, index providers have a wide range of **property rights in their indices**. There is an effective global market for the provision of indices with some of the larger and market leading providers being domiciled outside the European Union, but also offering indices to clients in Europe.*

#### 1.4. CONCLUSIONS

*As outlined above indices are used differently in the financial markets. Guidelines and safeguards are necessary to protect the markets from illegal actions. However, they should be drafted in a way which is proportionate and which supports the functioning of the markets in general and serves economic prosperity. For these reasons, the Commission should consider the differences between objective and subjective indices and the specific role of independent index providers. We conclude that*

- » *due to their specific set-up objective indices should not be subject to regulation;*
- » *independent index providers are best suited to calculate and operate subjective indices; and*
- » *neutral index providers offer a significant benefit to the market and regulation should rather be extended to other providers of indices related to market participants.*

##### 1.4.1. OBJECTIVE INDICES

*Objective and subjective indices are built up in a very different fashion and with very different levels of scrutiny.*

*Objective indices by their definition comply with the highest standards in terms of data quality and methodology and are already partly/indirectly regulated, e.g. they are built on regulated price sources, namely regulated markets. In summary:*

- » They provide the possibility of being fully replicated.
- » They use only distortion free market data.
- » Their methodology is transparent and does not contain any discretionary elements.
- » The integrity of the ongoing maintenance is ensured.
- » They adhere to the highest quality standards, both conceptually and technically.

*It is worth noting in addition that independently maintained objective indices have not generated frictions in the financial markets. On the contrary, the continuous improvements and innovations from the independent providers have enhanced the overall global market structure.*

**We conclude that there is *no justification for objective indices to be the target of regulatory intervention.***

#### 1.4.2. SUBJECTIVE INDICES

*For all the reasons that make these indices subjective – lack of transparency, inability to be replicated, inclusion of discretionary elements, lack of quality control – we believe that **regulatory focus and attention is required for subjective indices.** Additional guidelines and effective oversight would provide a valuable additional safeguard to the financial markets.*

*However, neutral index providers do not have conflicts of interest. Therefore, with the right set of guidelines and governance requirements, they are the best qualified to calculate, maintain and operate subjective indices. For all other market participants, further safeguards should be considered.*

**We regard *neutral index providers to be best suited to calculate and operate subjective indices, as they by their very nature strive to avoid conflicts of interest.***

#### 1.4.3. NEUTRAL INDEX PROVIDERS

*Although indices might in principle be provided by different entities, regulatory restrictions may especially limit the activities of neutral index providers.*

*We would argue in detail that neutral index providers*

- » *do not have a potential conflict of interest and therefore guarantee unbiased indices;*
- » *support effective competition in the products market; and*
- » *drive innovation for the benefit of all market participants.*

**We argue that *neutral index providers are best suited to provide indices for the market place to avoid conflicts of interest or related problems which appeared in the context of the LIBOR calculation.***