11 February 2013

Alp Eroglu
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Dear Mr Eroglu

Public Comment on Financial Benchmarks

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on IOSCO's Financial Benchmarks Consultation Report (the Report) issued on 11 March 2013.

AFMA is the leading industry association promoting efficiency, integrity and professionalism in Australia's financial markets. AFMA has more than 120 members reflecting the broad range of participants in financial market, including Australian and international banks, leading brokers, securities companies and state government treasury corporations, fund managers, energy traders and industry service providers.

AFMA's conventions and other standards promote best practice in over-the-counter (OTC) markets, transactions processing and other critical processes and support official regulation of the markets. AFMA also encourages high standards of conduct through professional development and accreditation programs. AFMA also provides market data services including a wide range of revaluation rates that are not benchmarks.

AFMA is the administrator and publisher of the BBSW benchmark rate, which is the central benchmark rate in the financial markets in Australia. AFMA is committed to ensure that BBSW remains an effective and well-regarded benchmark rate and over the years we have maintained a program of ongoing review to support this objective.

Public confidence in benchmark rates is a necessary condition for healthy financial markets that will support the broader economy. Events in some overseas markets have identified a need for greater regulation of benchmarks in those markets. AFMA supports the development of IOSCO principles for regulation that will encourage public confidence in the integrity of financial benchmarks generally.

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IOSCO's consultation is taking place at a time when benchmark rates are being reviewed in several jurisdictions and regulatory action is being taken that are introducing specific requirements into benchmark rate setting processes. IOSCO can play an important role by drawing these various stands of work into a cohesive and coherent set of principles that provide a framework within which the regulation of benchmarks can be conducted in a co-ordinated and consistent manner across jurisdictions.

In addition, because there is great diversity in the design and operation of benchmarks which fundamentally affects the risks they present, the IOSCO principles must enable the effective and proportionate application of regulation to each of those benchmarks.

If the IOSCO principles fail to promote a co-ordinated regulatory response and regulation that differentiates appropriately between distinctive benchmarks, then it could be counterproductive and in some instances undermine the quality price information being made available to the market through affected benchmark rates.

For instance, the definition of benchmark adopted in the Report is too broad and captures a range of price data that are not regarded or used by industry participants as benchmarks. The application of regulation designed for genuine financial benchmarks to these products would threaten their viability in many instances.

There is a risk at present that benchmarks in some jurisdictions may be significantly harmed as a result of efforts to address specific problems with benchmarks in others. Small jurisdictions, like Australia, are most vulnerable to this risk, as the current focus is on the problems that emerged in the large global economies. IOSCO should endeavour to ensure the viability of sound benchmarks for smaller regions as well as large.

As the Report notes, a one size fits all approach is not appropriate. Yet there is evidence that the compliance and regulatory structures that are being put in place to counter structural problems in some benchmarks are creating a problem for others that do not share these structures by adding unnecessarily to their costs. Regulatory action to date is having an extraterritorial effect and leading to the withdrawal of banks from submission processes, even when the rate set has been effective and trouble-free.

Given the increase to systemic risk from less effective benchmarks and a reduction in the availability of price data, it is appropriate for IOSCO to encourage national regulators to work through its processes to co-ordinate regulatory reform and to take steps to actively avoid potentially harmful extraterritorial effects of their actions.

IOSCO's task is an important one and it should be recognised that there are substantial risks if the correct outcomes are not achieved. In this regard, AFMA is concerned that the relatively short consultation period does not permit a sufficiently detailed analysis to be undertaken.

For a substantial and globally important regulatory review with far-reaching implications for financial markets and economies, a more appropriate structure would include a series of

consultation papers of significantly greater depth over a period of 6-12 months. This would allow for a properly structured and effective consultation with the industry.

Overall, there is a risk that the Report in its current form may not provide a sufficient basis to ensure prudent and balanced regulatory outcomes for all financial benchmarks.

Key points

To promote the objective of having financial benchmarks that serve a vital economic purpose and have public confidence, the regulatory principles for financial benchmarks that are adopted by IOSCO should:

- Recognise the unique risk profiles presented by different benchmark rate methodologies and underlying markets through a more detailed categorisation system;
- Avoid a one-size-fits all approach and, instead, recommend governance arrangements that are proportionate to these different risk profiles;
- Apply a consistent approach in relation to categorisation of benchmarks in relation to risk. These categories should include reference to requirements for sufficiency of data sampling, filtering, underlying market liquidity and transparency across all benchmark methodologies, and should avoid unwarranted prioritisation of trading data over committed quote data;
- Encourage regulators to mutually recognise regulatory frameworks in other jurisdictions that accord with IOSCO's principles and to avoid extra-territorial regulatory action that may negatively and inappropriately impact foreign benchmarks ;
- Narrow the definition of benchmark rate to better reflect the range of price data that constitute benchmark rates as the term is generally understood;
- Do not mandate participation in benchmark processes, in view of the risks and costs associated with this course of action for benchmarks derived from a traded market;
- Respect the validity and support the continued implementation of industry self-management or self-regulation in environments where appropriate intrinsic and extrinsic safeguards against rate manipulation exist;
- Do not mandate regulation of a benchmark administrator unless this form of regulation will address a demonstrated market failure in respect of the relevant benchmark; and
- Ensure that benchmark rates in smaller jurisdictions are not harmed or rendered unviable by governance structures designed to address higher risk rates in larger jurisdictions.

Conclusion

Having regard to the significance of the issues identified here, we encourage the Taskforce to consider a series of more in-depth and structured consultations on threshold issues. At a

minimum, IOSCO should make provision to enable full consideration of the issues raised during the current consultation and development of a well-designed response to them.

This letter summarises our response to the Report and more detail is given in the attachment, which contains the answers to the questions posed in the Report.

AFMA would be pleased to meet with IOSCO and share our thoughts and experiences in relation to benchmark processes generally.

David Lynch
Executive Director