

RBI releases Draft Directions on Financial Benchmark Administrators

The Reserve Bank of India has released draft directions on Financial Benchmark Administrators.

Background:

Reserve Bank of India had, in its Statement on Developmental and Regulatory Policies, the Fourth Bi-monthly Monetary Policy Statement dated October 05, 2018, announced that it will introduce a regulatory framework for financial benchmarks, to improve the governance of the benchmark processes in markets regulated by the Reserve Bank. It was also announced in the Statement on Developmental and Regulatory Policies, in the Sixth Bi-monthly Monetary Policy Statement dated February 7, 2019 that the draft guidelines would be issued for public consultation. Accordingly, draft directions on Financial Benchmark Administrators are being issued for consultation.

These draft directions are based on the Report of the Committee on Financial Benchmarks set up by the Reserve Bank and are guided by the International best practices such as the Principles for Financial Benchmarks of International Organization of Securities Commissions (IOSCO) as well as the laws/ regulations put in place in other jurisdictions.

Financial Benchmark Administrators (Reserve Bank) Directions, 2019 – Draft

The Reserve Bank of India (hereinafter called 'the Reserve Bank') having considered it necessary in public interest and to regulate the financial system of the country to its advantage, in exercise of the powers conferred by section 45W of the Reserve Bank of India Act, 1934, (hereinafter called 'the Act') read with section 45U of the Act and of all the powers enabling it in this behalf, hereby issues the following

Directions to Financial Benchmark Administrators. These directions are based on the practices recommended by the International Organization of Securities Commissions (IOSCO) in their report on Principles for Financial Benchmarks dated July 2013 and the Report of the Committee on financial benchmarks set up by the Reserve Bank on June 28, 2013.

Short Title and Commencement: These directions shall be called 'Financial Benchmarks Administrators (Reserve Bank) Directions, 2019' and shall come into force with effect from XXXX XX, 2019.

1. Scope: These directions shall apply to Financial Benchmark Administrators administering significant Benchmarks in the markets for Financial Instruments regulated by the Reserve Bank under Section 45 W of the Act. The directions shall not apply to any benchmarks issued by the Reserve Bank in furtherance of public policy objectives. These directions shall also not apply to internal benchmarks used by the clearing corporations recognised by the Reserve Bank of India or Securities Exchange Board of India for the purpose of internal risk management.

2. Definitions

- I. 'Administration' includes all stages and processes involved in the production and dissemination of a benchmark.
- II. 'Benchmarks' mean prices, rates, indices, values or a combination thereof related to financial instruments that are calculated periodically and used as a reference for pricing or valuation of financial instruments or any other financial contract.
- III. 'Calculating Agent' means a legal entity with delegated responsibility for determining a benchmark in accordance with the methodology set out by the administrator.
- IV. 'Financial Benchmark Administrator' (FBA) means an organisation or a legal person which controls the creation and operation of significant benchmark administration process, whether or not it owns the intellectual property relating to the benchmark.
- V. 'Financial instruments' mean instruments referred to or specified under section 45W of the RBI Act.
- VI. 'Methodology' in reference to benchmarks includes the process commencing from identification

of source of inputs for calculation of benchmarks to the final act/step of calculation resulting in the arrival of the benchmarks.

- VII. 'Significant benchmarks' means benchmarks notified by the Reserve Bank as significant benchmark under these Directions.
- VIII. 'Submitter' shall mean any natural or legal person contributing input data for determination of a benchmark.

3. (i) No FBA shall administer a significant benchmark without obtaining prior authorisation of the Reserve Bank under these directions.

(ii) FBAs administering significant benchmarks on or before the commencement of these directions shall make an application for authorisation within a period of three months from the date of issue of these directions. Notwithstanding anything contained in Para 3 (i) herein above, an existing benchmark administrator administering significant benchmarks may continue to administer such benchmarks till the disposal of its application by the Reserve Bank granting or rejecting the letter of authorization.

(iii) The identification of a benchmark as significant benchmark shall be based on use, efficiency and relevance of the benchmark in domestic financial markets. A Benchmark Committee, having representation from the Reserve Bank, market bodies such as FIMMDA, FEDAI, PDAI, or any other entity which the Reserve Bank may deem fit, shall be constituted to identify significant benchmarks in the markets for financial instruments. The Reserve Bank shall notify, based on the recommendations of the Committee, a list of significant benchmarks.

(iv) Minimum eligibility criteria for FBAs:

- a. FBA shall maintain a minimum net-worth of ₹ 1 crore at all times.
- b. FBA shall be a company incorporated in India.
- c. Shareholding by non-residents, if any, in the entity seeking authorisation as a FBA shall conform to all applicable laws and regulations, including the Foreign Exchange Management Act, 1999.
- d. FBA shall have robust governance arrangements with a well-defined, transparent

organisational structure to manage the activities of FBA. Directors shall be of good repute and experience.

- e. The representation in the Board of the company shall be broad-based with no legal person having greater than ten percent of voting rights in the Board.
- f. The existing FBAs shall achieve the minimum eligibility requirements within one year from the date of authorisation by the Reserve Bank.

4. FBAs shall adhere to the following directions in respect of their administration of significant benchmarks.

(i) Overall Responsibility of FBAs -

An FBA, in respect of the benchmarks administered by it, shall be responsible for

- a. formulation of benchmark calculation methodology;
- b. determination of benchmark values;
- c. dissemination of benchmark values;
- d. ensuring transparency in benchmark administration;
- e. periodic review of benchmark; and
- f. putting in place necessary organizational and process controls for effectively carrying out the above responsibilities.

(ii) Significant Benchmarks: Formulation, Determination and Review -

- i. FBAs shall endeavor to ensure, as far as possible, that a significant benchmark is designed to be an accurate and reliable representation of the referenced financial instrument(s).
- ii. FBAs shall, as far as reasonably practicable, ensure that the data used to construct a significant benchmark is based on an active market involving arm's length transactions; where such transactions are not available, it would have recorded justification for data, information or expert judgment used to construct the benchmark.
- iii. FBAs shall establish and publish clear guidelines regarding the hierarchy of data inputs and

- exercise of expert judgment used for the determination of significant benchmarks.
- iv. FBAs shall document the methodology of the significant benchmarks they are administering with illustrations and publish the same on their official website. The document shall inter alia give the details on:
 - a. the input for calculation of the benchmark;
 - b. sources of inputs;
 - c. basis and manner of selection of the sources of inputs;
 - d. method of calculation including the mathematical formulae used;
 - e. instances where the methodology would not be adhered to or not possible to be adhered to and alternate ways adopted to calculate the benchmark in such exceptional cases; and
 - f. rationale underlying the methodology and treatment of exceptions.
 - v. Amendments to methodology that FBAs decide to make shall be announced in their official website at least 15 days prior to their coming into effect. The announcement shall clearly delineate all aspects of methodology that would be amended. The announcement shall also explain the amended methodology with illustrations.
 - vi. FBAs shall lay down a formal process for interacting with market participants at any stage in the benchmark administration process.

(iii) Organizational and Process Controls: Oversight Committee -

- i. FBAs shall develop appropriate oversight function for regular review of various aspects of the significant benchmark determination process. The oversight function shall be carried out by a committee, specifically set up for carrying out the function.
- ii. The procedures involved in oversight function including criteria for selection of members; processes for selection, nomination, removal and replacement of members; and declaration of conflicts of interest shall be documented and made available to the stakeholders. The Board of an FBA shall have a policy to ensure that the Oversight Committee is not biased or conflicted through fair representation of major stakeholders.
- iii. No person in the Oversight Committee shall remain for more than 5 years either in one or

more terms.

- iv. The responsibilities of the oversight function shall include, among others, the following:
 - a. Periodic review of the definition and setting methodology of the significant benchmark.
 - b. Enabling seamless transition to a new benchmark whenever an existing significant benchmark is replaced, rescinded or amended.
 - c. Establishing appropriate system to gather information about the issues and risks involved with the significant benchmark.
 - d. Reviewing and overseeing of any changes to the significant benchmark setting methodology and assessing whether the changed methodology continues to appropriately reflect the underlying interest.
 - e. Overseeing the management and operation of the significant benchmark including the activities undertaken by a third party involved in Benchmark determination.
 - f. Ensuring that the exercise of expert judgment, if any, by the FBA is as per the laid down policies.
 - g. Following up for implementation of the remedial actions recommended in the audit reports.
- v. In case of significant benchmarks determined through submissions by contributing entities (Submitters), the oversight function shall
 - a. Oversee the compliance by the Submitters to the Code of Conduct, (ref. para 4 (iv) j), issued by the FBAs and institute an effective system to address breach of the Code by Submitters. The findings of the oversight shall be reported to the Reserve Bank.
 - b. Undertake regular review to detect potential anomalous or suspicious submissions and initiate necessary follow up action thereafter. The details of such submissions shall be reported to the Reserve Bank.

(iv) Internal Control

- i. FBAs shall ensure effective controls over data collection, storage, processing and

- dissemination to maintain data security, confidentiality and integrity.
- ii. FBAs shall document and implement policies, procedures and control framework for the identification, disclosure, management, mitigation or avoidance of existing and potential conflicts of interest. It shall, inter alia, address the conflict of interest that may exist between the significant benchmark determination process and any other business of the Administrator or any of its affiliates. The policies and procedure shall be periodically reviewed and updated.
 - iii. There shall be proper segregation of reporting lines within the FBAs to clearly define responsibilities and prevent any conflicts of interest or perception of such conflicts of interest.
 - iv. FBAs shall put in place an effective system to control the exchange of information between the employees engaged in activities involving a risk of conflicts of interest or between employees and third parties, where that information may reasonably affect the determination of significant benchmarks.
 - v. FBAs shall ensure that authorised employees supervise the significant benchmark determination process and approve the benchmark rates before they are disseminated.
 - vi. FBAs shall put in place appropriate confidentiality protocols with respect to the data and other information received by or produced by it, subject to the disclosure obligations.
 - vii. FBAs shall have adequate remuneration policies to ensure that employees engaged in benchmark determination are not directly or indirectly rewarded by the levels of the significant benchmark.
 - viii. FBAs shall ensure that employees involved in benchmark determination shall possess relevant expertise with a system of periodic review.
 - ix. In case of significant benchmarks determined based on submissions, FBAs shall
 - a. Ensure that the Submitters as a group appropriately represent the underlying interest measured by the Benchmark.
 - b. Employ a system of appropriate measures so that Submitters comply with submission guidelines, as defined in the Submitter Code of Conduct and the Administrator's quality and integrity standards for submission.
 - c. Employ measures to effectively monitor and scrutinize submissions.

- x. FBAs shall draw a code of conduct which the market participants submitting inputs for calculation of submission based significant benchmarks need to adhere to. The code of conduct shall include, inter alia, steps to be taken by the market participants to mitigate operational risks and eliminate conflict of interests.
- xi. FBAs shall have an adequate business continuity plan and contingency procedures to overcome disruptions to normal business.
- xii. FBAs shall carry out annual internal audit, either with internal resource or through independent external auditors, at the end of each financial year ending in the month of March, to verify compliance to their policies and procedures and directions, advices and instructions issued by the Reserve Bank. The audit reports shall be submitted to their board. It shall also be submitted to the Reserve Bank within thirty days from the completion of the audit. Action taken report on the audit findings, if any, shall be submitted to the Reserve Bank within such time as advised by the latter.

The Reserve Bank may itself or through entities/persons that it may identify for the purpose, audit the Administrator; and the cost of the audit shall be borne by the Administrator.

(v) Outsourcing of benchmark related work

- a. FBAs shall put in place transparent written policies setting out the roles and obligations of any third party handling the outsourced functions and regularly monitor its compliance with the policies. The identity and role of the third party shall be disclosed to the stakeholders. They shall also put in place appropriate contingency plans to manage operational risks involved in the outsourced functions.
- b. Where an FBA has outsourced significant benchmark calculation function to a Calculating Agent, it shall retain adequate access to and control over the data and calculation process and ensure compliance by the Calculation Agent with the policies stated by it as well as with the regulatory guidelines in this respect to the Calculating Agent, if any.
- c. In respect of any work related to benchmark administration that FBAs outsource to any entity, they shall be responsible for all acts of omissions and commissions of the entities to

which it has outsourced its work.

5. Complaint Management

- a. FBAs shall have a formal complaint handling mechanism to handle complaints related to significant benchmark administration.
- b. FBAs shall establish an effective whistleblower mechanism to facilitate early detection of any potential misconduct or irregularities in the significant benchmark determination process. This mechanism shall allow for external reporting of such cases where appropriate.

6. Data Preservation

FBAs shall preserve all data in their possession in connection with the significant benchmarks they administer for a period of five years from the time they received or created the data. Without prejudice to the aforesaid time period, data related to any legal case shall be preserved for a period of two years from the closure of the case.

7. Exemption from provisions of these directions

The Reserve Bank, on being satisfied that it is necessary to do so, may exempt an FBA either generally or for such period as may be specified, from any or all of the provisions of these Directions, subject to such terms or conditions or limitations or restrictions as it may think fit and proper to impose, in the interest of public or financial system of the country.

8. Revocation of authorisation

The Reserve Bank may revoke the authorisation granted to an FBA based on adverse findings/ observations or material violation of any of the provisions of these directions.

9. Termination of administration

An FBA, who is holding a letter of authorisation to commence or carry administration of a significant benchmark, may terminate its operation with prior approval of the Reserve Bank with regard to timing and date of termination of administration, and shall comply with the terms and conditions stipulated by the Reserve Bank.

10. Benchmark Publication

All FBAs shall publish in public domain, the values of significant benchmarks, either on the day of its release or with a lag not exceeding 10 days.

11. Reporting

FBAs shall submit such data and reports to the Reserve Bank within such timeline and in such format as advised from time to time.

RBI seeks inputs on the draft directions on Financial Benchmark Administrators and therefore, request you to please provide your suggestions (if any) latest by 28th February 2019 at research@phdcci.in

Please contact for any query related to this mail to Ms. Bhawna Kakkar, Research Associate at bhawna.kakkar@phdcci.in with a cc to Dr. S P Sharma, Chief Economist at spharma@phdcci.in and Ms. Surbhi Sharma, Associate Economist at surbhi@phdcci.in of PHD Chamber of Commerce & Industry.

Warm Regards,

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