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Glenn Stevens AC
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23 August 2016

The Hon Scott Morrison MP
Treasurer
Parliament House
CANBERRA ACT 2600

Dear Treasurer

COUNCIL OF FINANCIAL REGULATORS: REGULATION OF FINANCIAL BENCHMARKS

I write to you on behalf of the Council of Financial Regulators (CFR), setting out our recommendations for a regulatory regime for financial benchmarks. These recommendations have been jointly developed by the Australian Securities and Investments Commission (ASIC), the Reserve Bank of Australia, the Australian Prudential Regulation Authority and the Commonwealth Treasury.

Background

On 21 October 2015, I wrote to you on behalf of the CFR to recommend that the Government consult on regulatory reform for financial benchmarks. You subsequently agreed that there was a clear case for reform and on 24 November 2015, you asked the CFR to consult on options to reform the regulation of financial benchmarks and advise you of the CFR's recommended approach.

In line with your request, the CFR has consulted on the reform options that I conveyed to you in October 2015. The CFR received 19 submissions and held follow up meetings with stakeholders. There was strong support for reforming the regulation of financial benchmarks in Australia and stakeholders generally agreed with the positions put forward by the CFR.

The attached advice sets out the CFR's recommended approach. Consistent with your request, in finalising these recommendations, the CFR has considered the evolution of the methodology to calculate the Bank Bill Swap Rate (a significant financial benchmark in Australia) and the robustness of the proposed reforms to potential future developments. The CFR considers that the recommended reforms would:

- help to ensure the robustness and reliability of financial benchmarks in the Australian economy and thereby support continued confidence in Australia's financial markets;
- be aligned with international best practice wherever possible; and
- be capable of being applied in a proportionate manner that reflects the significance of a financial benchmark and the risks that may arise in relation to that financial benchmark.

Recommendations

To achieve the objectives outlined above, the CFR broadly recommends that:

- significant benchmarks (broadly, systemically important benchmarks and those that will have a significant impact on investors) be covered by the regulatory regime;
- significant benchmarks be identified in a publicly accessible list that can be amended;
- administrators of significant benchmarks be required to hold a new, standalone, 'benchmark administration licence' unless granted an exemption, and the licence be supported by ASIC powers to write rules imposing obligations;
- an 'opt-in' mechanism be created to allow administrators of non-significant financial benchmarks to apply to be licensed if they meet licensing requirements and doing so has value;
- submitters to regulated benchmarks be required to comply with ASIC rules on regulatory matters related to benchmark submission, with benchmark administrators having primary responsibility for the operation of the benchmark;
- ASIC be given the power to write rules to compel submission to a significant benchmark as a last resort when necessary to support market functioning;
- the manipulation of any financial benchmark (significant or non-significant) be made a specific criminal and civil offence; and
- Bank Accepted Bills and Negotiable Certificates of Deposit be expressly made financial products for the purposes of the offence provisions of Chapter 7 of the Corporations Act 2001.

Conclusion

As noted in the attached advice, the CFR recommends that the administration of, and the making of submissions to, a significant financial benchmark be regulated and that the Government consider making the manipulation of any benchmark a specific offence.

The CFR is available to answer your queries about the above recommendations and to assist Government with the implementation of the recommended reforms, as required.

Yours sincerely

cc: The Hon Kelly O'Dwyer MP, Minister for Revenue and Financial Services
Mr Wayne Byres, Chairman, Australian Prudential Regulation Authority
Mr Greg Medcraft, Chairman, Australian Securities and Investments Commission
Mr John Fraser, Secretary, Department of the Treasury

Council of Financial Regulators: Recommended approach for regulatory reform of financial benchmarks

Contents

1. Executive Summary

In March 2016, the Reserve Bank of Australia (RBA), the Australian Securities and Investments Commission (ASIC), the Australian Prudential Regulation Authority (APRA) and the Commonwealth Treasury — together comprising the Council of Financial Regulators (CFR) – released a consultation paper seeking stakeholder views on options to reform the regulation of financial benchmarks in line with the International Organisation of Securities' Commission's (IOSCO's) *Principles for Financial Benchmarks* (the IOSCO Principles).

These reforms are necessary to ensure:

- continued confidence in Australia's financial markets' architecture; and
- that products referencing Australian financial benchmarks can continue to be traded in critical overseas markets (such as the European Union (EU)).

Consultation closed in early May 2016 and the CFR received 19 written submissions. Between May and July 2016 the CFR held discussions with respondents.

Stakeholders showed strong support for reforming the regulation of financial benchmarks in Australia, agreed that regulatory reform should be consistent with international best practice, and generally agreed with the positions put forward by the CFR.

Stakeholders' feedback has been critical in refining the CFR's position on a number of issues, in particular the preferred option for regulating administrators and the preferred option and scope of regulation for submitters.

In settling on the recommended reform proposals, the CFR has been guided by the following principles:

- the reforms should help to ensure the robustness and reliability of financial benchmarks in the Australian economy and continued confidence in Australia's financial markets;
- the reforms should be aligned with international best practice wherever possible; and
- the reforms should be capable of being applied in a proportionate manner that reflects the significance of a financial benchmark and the risks that may arise in relation to that financial benchmark.

The CFR recommends to the Government that:

- significant benchmarks (broadly, systemically important benchmarks and those that will have a significant impact on investors) be covered by the regulatory regime;
- significant benchmarks be identified in a publicly accessible list that can be amended;
- administrators of significant benchmarks be required to hold a new, standalone, 'benchmark administration license' unless granted an exemption, and the license be supported by ASIC powers to write rules imposing obligations;
- an 'opt-in' mechanism be created that would allow administrators of non-significant financial benchmarks to apply to be licensed if they meet licensing obligations and there is commercial and regulatory value;
- submitters to regulated benchmarks be required to comply with ASIC rules on regulatory matters related to benchmark submission, with benchmark administrators having primary responsibility for the operation of the benchmark;
- ASIC be given the power to compel submission to a significant benchmark as a last resort when necessary to support market functioning;
- the manipulation of any financial benchmark (significant or non-significant) be made a specific criminal and civil offence; and
- Bank Accepted Bills (BABs) and Negotiable Certificates of Deposit (NCDs) be expressly made financial products for the purposes of the offence provisions of Chapter 7 of the *Corporations Act 2001* (the Corporations Act).

The CFR's initial reform proposals, stakeholder feedback, and recommended approach are summarised in Table 1.

Table 1: Comparison of consultation and post-consultation proposal

Consultation Proposal	Stakeholder Views	Final Proposal
Scope of Reform		
Significant benchmarks (broadly those that are systemically important) will be subject to regulation.	Stakeholders supported the CFR's proposal.	Significant benchmarks (broadly, systemically important benchmarks and those that have a significant impact on investors) would be subject to the full suite of regulation.
Significant benchmarks would be either listed in legislation, determined using fixed criteria, or an initial list would be set out in legislation and ASIC would have the power to amend such list as necessary.	Stakeholders asked for certainty about which benchmarks have been identified as significant. Stakeholders asked for flexibility to add or remove benchmarks.	Legislation or regulations would be used to provide an initial public list of significant benchmarks and ASIC would be able to prescribe additional benchmarks as significant if they meet the criteria.
Regulating Benchmark Administrators		
Benchmark administrators could be directly regulated through the Australian financial services licence (AFSL) regime or market integrity rules.	Stakeholders supported regulating significant benchmarks' administrators, but pointed out pros and cons of options for regulation. Some suggested a new dedicated licence regime.	Administrators of significant benchmarks would be required to hold a new, standalone, 'benchmark administration license' and be required to comply with ASIC rules.
Potential exemptions for some benchmark administrators.	Stakeholders supported exemptions for administrators, where appropriate.	ASIC would have exempting powers under the licence regime consistent with existing regulatory models.
	A stakeholder proposed an opt-in mechanism for administrators of non-significant benchmarks.	Administrators of non-significant benchmarks would be able to 'opt in', if they meet the requirements and doing so had value.
Regulating Submitters/Submissions		
Regulatory options included indirect regulation via an administrator-controlled code of conduct; market integrity rules; or licence conditions.	Stakeholders supported the proposal to regulate submission. However, most stakeholders did not think indirect regulation by way of a code of conduct would be effective.	Submitters to regulated benchmarks be required to comply with ASIC rules on regulatory matters related to benchmark submission, with benchmark administrators having primary responsibility for the operation of the benchmark.
Introducing a Compulsion Power		
Entities could be compelled to make submissions to a significant benchmark.	Stakeholders broadly supported CFR's proposal.	ASIC would be given the power to write rules to compel submission to a significant benchmark as a last resort.
Strengthening Offences around benchmark manipulation		
New offence provisions be introduced for manipulation of any benchmark.	Most stakeholders supported CFR's proposal, though some proposed a narrower scope for the criminal offence.	Manipulation of all (significant and non-significant) benchmarks would be made a specific criminal and civil penalty offence.
BABs and NCDs could be expressly made financial products for the purposes of the Corporations Act.	Stakeholders supported CFR's proposal in certain circumstances.	BABs and NCDs would be made financial products for the purposes of the Corporations Act Chapter 7 offence provisions.

2. Additional detail on the CFR's proposed approach

Additional detail on the options for reform initially put forward by the CFR, feedback on the options, and the reasoning behind the CFR's final position are detailed below.

2.1 Scope of reform

CFR proposals

The CFR initially proposed that only significant benchmarks be subjected to additional regulation. This is in line with the proportionality that is central to the IOSCO Principles. The definition of benchmarks would take the IOSCO Principles as a starting point.

The CFR proposed that a benchmark would be 'significant' if there was a material risk of financial contagion or systemic instability if the availability or integrity of the benchmark was disrupted. Other factors put forward as potentially relevant to the significance of a benchmark included the materiality of the impact on retail or wholesale investors if the availability or integrity of the benchmark is disrupted.

The CFR's consultation paper (March 2016) proposed that five benchmarks are likely to be significant benchmarks:

- the Bank Bill Swap Rate (BBSW);
- Standard & Poor's (S&P)/ASX 200 index;
- ASX Bond futures settlement price (formerly CGS yield curve survey)
- the cash rate (including the Total Return Index derived from the cash rate); and
- the Consumer Price Index.

The CFR also sought views on three options for identifying significant benchmarks.

- A 'list only' option;
- a 'criteria only' option; and
- a hybrid of the list and criteria options (that is, a list in a legislative instrument that could be amended by both the Government and ASIC).

Feedback

Respondents generally agreed that it was appropriate and proportionate for a licensing regime to focus on significant benchmarks.

In relation to the criteria for identifying significant benchmarks, some respondents suggested additional criteria for determining significance or sought additional clarification on proposed criteria. Proposed criteria included:

- Whether the benchmark is readily substitutable?
- Whether there are conflicts of interest in the benchmark administration process?

- Whether the input data is sourced from a regulated venue?
- Whether it would be preferable to provide objective verifiable quantitative measures, if benchmark administrators would be expected to self-assess whether their benchmarks would be significant?

Most respondents expressed a preference for having a list of significant benchmarks published by the Government or regulators. This was seen to provide certainty about which benchmarks have been identified as significant.

With regards to the benchmarks identified as being potentially significant in the consultation paper:

- most agreed that the BBSW and the ASX Treasury Bond Futures expiry settlement prices are appropriate benchmarks to be brought within the scope of regulation;
- a number of respondents indicated that equity indices such as the S&P/ASX200 should not be subject to regulation, while others highlighted the need for equity indices to be subject to equivalent regulation so that they can be 'passported' into other jurisdictions including the EU; and
- a small number of additional financial benchmarks were suggested as potentially significant, including the WM/Reuters Australian dollar foreign exchange benchmarks.

CFR advice

In light of overall stakeholder support for the proposal to apply regulation to significant benchmarks, the CFR advises the Government to fix the scope of these reforms accordingly.

In this context, the CFR considers that significant benchmarks should be defined using the criteria that were proposed in the consultation. This is because the criteria, as proposed, provides an appropriate level of flexibility for the regulators to consider all factors that may be relevant to each benchmark under assessment (even if they are not numerically quantifiable factors). If the CFR's advice was adopted this would mean that:

- significant benchmarks would be defined as benchmarks that are systemically important and would present a material risk of financial contagion or systemic instability if the availability or integrity of the benchmark is disrupted; and
- other factors that may be relevant to the significance of a benchmark include the materiality of the impact on retail or wholesale investors if the availability or integrity of the benchmark is disrupted.

Based on these criteria, the five benchmarks identified in the consultation paper are likely to be considered to be significant. The WM/Reuters Australian dollar foreign exchange benchmark could also be considered to be significant.

Reflecting stakeholder feedback on the need for certainty about which benchmarks are considered to be 'significant', the CFR proposes that the Government adopt a hybrid mechanism for identifying significant benchmarks. That is:

- legislation or regulations would be used to provide an initial public list of significant benchmarks; and
- ASIC would have the power to prescribe additional financial benchmarks, if they met the criteria for significant benchmarks and after due process for the prescription of a new benchmark was undertaken.

This would:

- provide a high degree of certainty for industry;
- remove any risk associated with making such assessments from benchmark administrators and market participants; and
- would have some degree of flexibility to allow regulators to respond to market developments.

Flexibility would enable the regulators to add or remove a benchmark from the list of significant benchmarks as changes in the significance of a benchmark are identified. This would avoid potential delays in bringing the administrator of a new significant benchmark within licensing, or removing the requirement for an administrator to hold a license when no longer significant.

For these reasons, it is proposed that an annual assessment of significance is not required. Instead, the CFR recommends that to add a benchmark to the list of significant benchmarks, ASIC, in consultation with RBA and APRA, would make an assessment if and when there is a potential benchmark identified. Under such a framework a similar process would be used to remove a significant benchmark from the list. While one stakeholder thought the regulatory regime could have wider application if the regime was capable of applying different levels of obligations depending on the importance of the benchmark, the CFR considers that the current scope of the proposed regime is appropriate when balanced with the proposal to introduce new offences that have wider application.

2.2 Regulating Benchmark Administrators

CFR proposals

The CFR proposed that the administrators of significant benchmarks should be directly regulated by ASIC and have to comply with obligations consistent with the IOSCO Principles (including audit, governance and conflicts management requirements).

The CFR sought views on two options for regulation:

- making benchmark administration a type of financial service and thereby requiring benchmark administrators to hold an Australian financial services licence (AFSL); or
- imposing obligations on administrators using an ASIC rulemaking power, modelled on ASIC market integrity rules or derivative trade repository rules.

Feedback

Respondents generally supported the proposal to regulate the administrators of significant benchmarks. While a small number of respondents proposed that it would be preferable to rely on alternative mechanisms, such as requiring product issuers, exchanges and central counterparties to only use benchmarks compliant with the IOSCO Principles, others emphasized the need to ensure that benchmarks such as the BBSW can be recognised as equivalent under key overseas regulatory regimes for financial benchmarks.

Respondents provided a range of views on the legal mechanism to be used for regulating administrators. While some supported the use of the AFSL regime (an existing mechanism that would not require further legislative reform), others considered that a stand-alone licensing regime would be preferable. It was noted that a separate mechanism would allow licensing obligations to be more targeted to addressing the risks arising from benchmark administration and be better aligned with the IOSCO Principles.

An additional suggestion was to create an opt-in mechanism that would allow administrators of non-significant benchmarks to apply for a licence and be subject to regulation, if the administrator considered there is value, and if the administrator meets the licensing requirements applicable for a 'significant' benchmark.

While not specifically canvassed in the consultation paper, some stakeholders provided additional information about how some benchmarks are determined, particularly where the methodology, sources of data, and governance arrangements are different from those of the major interest rate benchmarks. A small number of stakeholders also highlighted the relevance of IOSCO's *Principles for Price Reporting Agencies* (PRA Principles) in relation to commodities financial benchmarks.

CFR advice

The CFR has revised its recommended approach to regulating benchmark administration.

The CFR recommends that the administrators of significant benchmarks be subject to a new, stand-alone licensing regime, with ASIC to have the power to write rules imposing licence obligations and to provide exemptions from some or all licence obligations. This revised proposal incorporates elements of each of the options consulted on and the legal mechanism could be modelled on Australia's derivative trade repository regime in Part 7.5A of the Corporations Act.

The CFR is of the view that a licensing regime with an ASIC rulemaking power has a number of advantages:

- The obligations under the licence would be adapted to the activities and risks of benchmark administration, compared to the general obligations relating to the provision of financial services under the AFSL regime.
- Rules can provide greater clarity on how licensees would be expected to comply with some of the IOSCO Principles.
- Compared to hard-wiring obligations in legislation, rules can give ASIC more flexibility to accommodate a range of benchmark determination methodologies (such as whether data is

sourced from market participants or commercial data vendors), governance structures, and other features as required. Importantly, ASIC can also respond in a timely manner to market developments.

- Having a specific licence regime can also assist with equivalence assessments, which can allow Australian-licensed benchmarks to be used in overseas markets.

Under the proposed regime, the administrator of a significant benchmark would be required to be licensed, unless they received an exemption from ASIC (ASIC would have the ability to impose conditions on the exemption). This is consistent with existing regulatory models.

Alternatively, legislation or regulations could also be used to provide an exemption. If supported by Government, the CFR will further consider and advise the Government in relation to licensing exemptions.

Licensed administrators would be required to comply with ASIC rules. The CFR contemplates that the rules should:

- impose obligations aligned with the IOSCO Principles and, if appropriate, the commodity specific IOSCO PRA Principles;
- impose obligations additional to the IOSCO Principles if necessary , for example, to address a specific risk or facilitate an equivalence decision; and
- If necessary for a class of benchmarks, relieve or tailor certain obligations so that the regime applies in an appropriate and proportionate manner.

Similar to rulemaking powers in general, under the recommended approach ASIC would have the ability to exempt an entity or class of entities from the requirement to comply with particular provisions of the rules if there were grounds for doing so. Further, ASIC could impose conditions on such exemptions.

These features of the licensing regime and rulemaking power would give the Government and ASIC the flexibility to set rules for each benchmark administrator in a way that takes the specific characteristics of each benchmark into account. Equally importantly, these features of the licence regime could also facilitate regulatory harmonisation and avoid conflict or duplication between Australian and foreign regulatory regimes.

The licence regime, as proposed, would not distinguish between benchmark administrators solely based on their domicile. A financial benchmark primarily used, and having material impact, in Australia may be administered by an overseas-, or domestic-, domiciled entity. As such, the licensing regime should be capable of applying to the administrators of all benchmarks that have been identified as significant, regardless of where the administrators are domiciled.

To support the development and growth of other benchmarks, the CFR also recommends that administrators of non-significant benchmarks be able to opt-in to be licensed by applying for a benchmark administration licence if they believe that there is regulatory and/or commercial value in doing so and they meet the licensing requirements. Regulatory and commercial benefits may include

the ability to 'passport' the administrator's benchmarks into overseas markets and investors' attraction to using a regulated benchmark.

If this recommendation is accepted by the Government, the CFR will consider further if there should be additional criteria for ASIC issuing a licence to an opt-in benchmark administrator. It is envisioned that if ASIC granted a licence to an opt-in administrator, the licensing obligations would apply in the same way as they would apply to licensees that are significant benchmark administrators. This would ensure that the integrity of licensed benchmark administration is maintained.

2.3 Regulating Benchmark Submitters

CFR proposals

Consistent with the IOSCO Principles, the CFR proposed imposing binding requirements on submitters to a significant benchmark.

The CFR sought views on four options for regulating submission to significant benchmarks:

- indirect regulation via obligations imposed on benchmark administrators;
- direct regulation by ASIC under the AFSL regime (for entities that are licensees);
- direct regulation by ASIC using a rulemaking power modelled on ASIC's market integrity rules or derivative transaction rules; and
- self-regulation under an ASIC-approved 'Code of Submitter Conduct'.

Feedback

Respondents generally supported the proposals to regulate submissions to significant benchmarks.

Respondents provided a range of views on the preferred mechanism to regulate submitters. Although there was support for each option, most respondents acknowledged that indirect regulation via a submitter code of conduct would not be an effective means of regulating submission without additional supporting regulation.

CFR advice

As a guiding principle, the CFR believes it is important to distinguish between the role of regulators and the role of benchmark administrators with respect to regulating benchmark submission. That is, benchmark administrators should retain primary responsibility for operating a benchmark, including by setting a submitter code of conduct and by putting in place the necessary commercial arrangements to enable a benchmark to be determined. Despite this, while benchmark administrators are best placed to develop and assess the input and control requirements for their benchmarks, the CFR believes that there is a need for direct regulation to address regulatory issues relating to submissions to a significant benchmark.

Consequently, the CFR recommends that the Government introduce an ASIC rulemaking power and for ASIC to write enforceable rules for matters that are of regulatory concern (such as record

keeping, governance of the submission process and data quality) in relation to submission to a regulated benchmark.

It is important that any rulemaking power for benchmark submission provide a reasonable degree of flexibility. Flexibility would be necessary to ensure that rules relating to submission are capable of accommodating, and are responsive to, the risks arising from submission to benchmarks determined by different calculation methodologies and administered under different governance structures – both of which can evolve over time. Flexibility is also required to address any regulatory harmonisation and equivalence considerations arising out of other jurisdictions.

To achieve these objectives, the CFR recommends that any legislation to support a rulemaking regime should enable the rules to apply to a range of entities that may make a submission to a significant benchmark. The regime should also enable ASIC to relieve or tailor the application of certain rules according to the submitter entity or according to the subset or class of benchmark. ASIC should also be able to provide exemptions from the rules (including exemptions subject to conditions), where appropriate.

2.4 Compulsion Power

CFR proposals

The CFR proposed to create a legal power to compel submission (that is, a power requiring the submission of an expert opinion) to a significant benchmark.

The CFR sought views on four options to compel submission:

- rely on a code of conduct or contractual obligations;
- impose a licence condition on entities that hold an AFSL;
- rely on an ASIC rulemaking power; or
- have ASIC issue a declaration that identifies entities or a class of entities that are subject to compulsion for each significant benchmark, as required.

Feedback

A majority of respondents agreed with the proposal to introduce a compulsion mechanism and all respondents agreed that a compulsion power should be exercised by one of the regulators.

There were a range of views on the preferred legal mechanism to compel submission. For example, while some preferred rulemaking powers, others considered that submission should be a condition of a submitting entity's AFSL.

While most respondents agreed that a compulsion power should be used as a last resort, others queried whether a compulsion power could be used to support other aspects of a transactions-based benchmark determination methodology.

Some suggested that the compulsion power should have some degree of proportionality that limits the scope of who can be compelled to submit, which could be determined by reference to scale,

market position, or participation in the underlying instrument/s. However others supported capturing as wide a range of market participants as possible.

Stakeholders raised a number of additional questions including:

- whether the power should extend to official sector benchmarks, even if those benchmarks are exempt from licensing? And
- whether a submitter should have the opportunity to respond to or appeal the decision to compel submission?

CFR advice

In addition to rules that address regulatory requirements relating to submissions, the CFR recommends that the Government provide a rulemaking power that would also enable ASIC to write rules that could compel submission to a significant benchmark as a last resort. The CFR believes that the exercise of any such compulsion power falls appropriately within the role of the regulators rather than the role of the benchmark administrator.

While the CFR envisages that the rules would set out the details of a compulsion regime, the CFR recommend that a separate decision be required before any entity may be compelled to submit to a significant benchmark. This would mean that the compulsion regime would be ready to become enlivened at short notice only if and when it becomes necessary. This is consistent with stakeholder views that compulsion be used as a last resort.

If supported by Government, the CFR expects that rules to support compulsion would cover:

- who may be subject to an exercise of compulsion power;
- the procedure of being compelled, including whether there is a right of reply; and
- the requirements that would apply to such entities if compulsion is applied.

The CFR also expects the specifics of the regime, including the cohort of entities that could be subject to compulsion, would be developed further in consultation with industry.

2.5 Strengthening offences relating to benchmark manipulation

CFR proposals

The CFR proposed that a new specific criminal and civil offence of benchmark manipulation applicable to all financial benchmarks (significant and non-significant) be introduced.

The CFR proposed criminalising two types of conduct (modelled on existing market misconduct provisions in the Corporations Act). That is:

- making false or misleading statements (including by providing false or misleading data) in connection with the determination of a benchmark; and
- engaging in dishonest conduct in relation to, or conduct that has or is likely to have the effect of creating or causing the creation of a false or misleading appearance with respect to trading

(or the price for trading) in financial products that affects, the determination of the benchmark.

The CFR also sought views on the jurisdictional reach of the offence provisions and whether this should be different for benchmarks that are administered in Australia or outside of Australia.

Separately, the CFR proposed expressly extending the scope of 'financial products' for the purposes of Part 7.10 of the Corporations Act to cover certain financial products such as BABs and NCDs.

Feedback

The majority of respondents supported making benchmark manipulation a specific criminal and civil offence, with some variation of views in respect of the application of the criminal offence to non-significant benchmarks. A couple of respondents questioned the need to create a new offence, rather than expanding the scope of the existing market misconduct regime in Part 7.10 of the Corporations Act.

To support market integrity more broadly, a majority of respondents agreed that a new benchmark manipulation offence should extend to all financial benchmarks, not just significant benchmarks. One respondent suggested that the scope of the offence be subject to de minimis criteria based on the benchmark's significance and risk of manipulation. Some stakeholders thought that the offence should only apply to designated significant benchmarks. Similarly, one respondent suggested that a criminal penalty would be appropriate for manipulation of a significant benchmark while a lighter regulatory or civil liability approach would be appropriate for manipulation of a non-significant benchmark.

Further, some respondents raised specific questions. For example:

- whether the definition of 'financial benchmark' creates uncertainty about which products are or are not benchmarks, and therefore uncertainty about the scope of the offence provision;
- whether inadvertent errors or unintentional conduct may be prohibited under the offence provision, potentially creating a 'chilling' effect. These respondents proposed the offence provision provide a 'good faith' defence or not apply to honest mistakes, which would be consistent with comparable offence provisions in the EU and the United States (US); and
- whether it would be a disproportionate response to seek a criminal sanction for minor breaches or conduct that may have narrow impact (for example, conduct that affects a benchmark that is purely internal to an organisation).

A few respondents commented on the jurisdictional scope of the offence, in particular whether:

- submissions should be regulated in the jurisdiction in which the benchmark is administered? And
- Australian regulators should only take action against an entity in relation to an overseas-administered benchmark if the entity is not facing or has not already faced enforcement action in the overseas jurisdiction?

A number of stakeholders emphasised that the offence should not apply to unintentional conduct or errors, as doing so could deter market participants from making voluntary submissions. One suggested that the offence of making a false or misleading statement should only apply to materially false or misleading statements.

The majority of respondents did not address the proposal to expressly provide that BABs and NCDs are financial products. Those that did address this question were supportive of the proposal. Two respondents only supported applying Part 7.10 of the Act to BABs and NCDs, while another was of the view that NCDs are already within the definition of financial products and therefore that no reform was needed for that product.

CFR advice

The CFR considers that introducing a specific offence for financial benchmark manipulation would, together with licensing of administrators and regulation of submissions, provide the most effective and mutually reinforcing reform package.

Response to questions raised

The CFR has considered each of the questions raised by stakeholders. In response:

- The CFR notes the definition of financial benchmark is currently proposed to be aligned with the definition used in the IOSCO Principles and with definitions used in key overseas regimes. Nonetheless, to add further clarity, the legislation or regulations could specify certain products that are to be taken to satisfy the definition of benchmark and/or certain products that are to be taken to be excluded from the meaning of benchmark. A similar mechanism exists in relation to the definition of key terms under the Corporations Act as 'financial product' or 'derivative'.

- In accordance with the general principles of criminal liability set out in Chapter 2 of the *Commonwealth Criminal Code*, the offence proposed by the CFR would only be contravened if a person knew or was reckless to the circumstance or result of their conduct. Accordingly, an offence would only be committed if a person knew or was reckless to the fact that the statement they made was false or misleading, that their conduct was dishonest, or that their conduct has or was likely to have the effect of creating or causing the false or misleading appearance. This general principle would have broadly the same effect as the 'good faith' or the 'honest mistake' defences highlighted by respondents.

- The CFR notes that existing market manipulation offences do not distinguish between financial markets or between financial products, and that action taken in respect of identified misconduct is guided by ASIC's long standing practice to pursue enforcement outcomes proportionate to the seriousness of the misconduct and its market impact, having regard to all of the relevant circumstances.

In relation to the suggestion that the proposed criminal and civil offences have different scopes, the CFR believes that the offence's intended market integrity benefits would be curtailed if the criminal offence were to be of a narrower scope than the civil liability offence, irrespective of the severity of the misconduct. Narrowing the scope of the offence may therefore not help to promote confidence

that all financial benchmarks used in the Australian financial system accurately reflect the underlying interest that they are intended to measure.

Jurisdictional reach

In regards to the jurisdictional reach of the proposed offence, the CFR no longer proposes to treat benchmark administrators, or the benchmarks administered by benchmark administrators, differently on the basis of whether the benchmark is administered in Australia or in another jurisdiction.

The global nature of financial markets could result in significant Australian benchmarks being administered from overseas. Similarly, on the submission side, some participants have established independent teams of submission personnel located separately from trading desks and, in some cases, located in its overseas headquarters from where they make all benchmark submissions.

Therefore, instead of focusing on the location of benchmark administration, the CFR recommends that any criminal offence and civil liability provisions focus on conduct relating to the determination of benchmarks that has the relevant impact in Australia, even if that conduct occurs outside of Australia. Accordingly, the CFR recommends that the offence apply to:

- Conduct, whether occurring in Australia or elsewhere, in relation to:
  - financial benchmarks that have been identified as significant benchmarks in Australia; and
  - financial benchmarks that are used in Australia. A benchmark is used in Australia if it is used or referenced:
    (a) in a financial product that is able to be traded on a financial market operated in Australia; or
    (b) on a financial market operated in Australia; or
    (c) in a financial product issued in Australia.
- Conduct occurring in Australia in relation to:
  - any financial benchmark. This would contribute to positioning Australia as a jurisdiction of sound integrity with regard to benchmark-related activities and would also enable ASIC to assist overseas regulators in accordance with established practices of supervisory and regulatory cooperation.

Recommended offences

The CFR proposes that the new criminal offence and civil liability provisions prohibit the following types of behaviour. These are broadly the same as the proposals consulted on:

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

- engaging in dishonest conduct in relation to the determination of a benchmark (whether alone or in combination with other conduct of the same kind, whether by the same or different persons); and
- engaging in conduct that has or is likely to have the effect of creating or causing the creation of a false or misleading appearance with respect to trading or the price for trading in financial products that may affect the determination of a benchmark (whether alone or in combination with other conduct of the same kind, whether by the same or different persons).

Lastly, in line with stakeholder feedback, the CFR recommends that the Government, in order to provide regulatory clarity, define BABs and NCDs as financial products for the purposes of the offence provisions of Chapter 7 of the Corporations Act.

3. Timing and Next Steps

To ensure that Australian market participants' ability to continue to use key benchmarks, including in transactions with overseas entities, is not disrupted, reforms equivalent to those implemented overseas must be in place by 1 January 2018.

To achieve this, legislation would ideally be considered by the Parliament in the 2017 Winter sittings. This should allow enough time for consideration of the bills by a Senate Committee, if required, and still allow passage by end-2017.

In the short term, however, once the Government has decided on its approach to reforming the regulation of financial benchmarks it will be important for the Government to make this position clear to the financial market. This regulatory certainty will support:

- continued trade in the market underpinning the BBSW, which has been consistently weak over the past year; and
- AFMA's process to transfer its responsibility for the administration of the BBSW to a new administrator by providing some further clarity on the proposed regulatory landscape.

CFR agencies will work closely with the Government over the next 18 months to support the implementation of these reforms, as required.