4th floor
Ropemaker Place
25 Ropemaker Street
London
EC2Y 9LY
United Kingdom

tel +44 20 7260 2000
fax +44 20 7260 2001
www.markit.com

Bank of England
Threadneedle Street
London EC2R 8AH

Submitted via FEMR@bankofengland.co.uk

London, January 30, 2015

Fair and Effective Markets Review: How fair and effective are the fixed income, FX and commodities markets?

Dear Sirs,

We welcome the publication of the Fair and Effective Markets Review Consultation Document: "How fair and effective are the fixed income, foreign exchange and commodities markets" (the "***CD***") and we appreciate the opportunity to provide you with our comments.[1]

Markit is a leading global diversified provider of financial information services. We provide products that enhance transparency, reduce risk and improve operational efficiency. By setting common standards and reducing the cost of compliance with regulatory requirements, many of Markit's services help level the playing field between small and large firms and herewith foster a competitive marketplace.[2] Our customers include banks, hedge funds, asset managers, central banks, regulators, auditors, fund administrators and insurance companies. Founded in 2003, we employ over 3,500 people in 10 countries. Markit shares are listed on Nasdaq under the symbol MRKT.

Markit has been actively and constructively engaged in the debate about regulatory reform in financial markets, including topics such as the implementation of the G20 commitments for OTC derivatives and the design of a regulatory regime for benchmarks. Over the past years, we have submitted more than 115 comment letters to regulatory authorities around the world and have participated in numerous roundtables. We regularly provide relevant authorities with our insights on current market practice, for example, in relation to valuation methodologies, the provision of scenario analysis, or the use of reliable and secure means to provide daily mid-market marks. We have also advised regulatory authorities on appropriate approaches to enabling a timely and cost-effective implementation of newly established regulatory requirements, for example through the use of multi-layered phase-in or by providing market participants with a choice of means for satisfying regulatory requirements.

[1] Fair and Effective Markets Review Consultation Document: "How fair and effective are the fixed income, foreign exchange and commodities markets?" (October 2014).
[2] For example, Markit's KYC Services provide a standardized end-to-end managed service that centralizes "Know Your Client" (KYC) data and process management.

Comments

We appreciate the general approach of the Review and we fully support its principles, namely the recognition that "markets are the best source of dynamism, prosperity and progress"[3] and that any market-led changes should be supported, but also the realization that FICC markets are global in nature and differ markedly between asset classes. That said, please find below our comments on some of the issues that were raised in the CD.

Specifically, we believe that: (a) any regulation of benchmarks should be proportionate and recognize the fact that the IBORs were an extreme case; (b) in order to ensure that the market for indices and benchmarks continues to be innovative and vibrant, administrators should be provided the authority to deem an index a "benchmark" by providing consent to its use as such, binding codes of conduct should only be required in the context of Critical Benchmarks, and intellectual property rights should be respected; (c) to create a level playing field between competing benchmark providers, authorities globally should encourage administrators to comply with the IOSCO Principles for Financial Benchmarks; (d) there seems little need for the Review to take action in relation to the further standardisation of OTC derivative products; (e) the Review should consider the significant risks of liquidity fragmentation and possible impact on competition that an overly aggressive push towards electronic trading can create, whilst ensuring that open, non-discriminatory access is also provided to 3rd party connectivity providers; (f) many transparency-creating services already exist and additional post-trade transparency will be provided under MiFID II in the future, whilst transactional prices are often only one of the many inputs into the pricing of less liquid financial products; and (g) for the surveillance of transactions one should pursue a comprehensive top-down approach, focusing on identifying abnormal profits, with surveillance being performed in an automated manner where appropriate given transaction volumes.

Benchmarks[4]

The CD discusses the recent misconduct in major FICC markets, specifically the manipulation of Libor, Euribor and other similar benchmarks.[5] It also asks questions about potential changes to the design and governance of benchmarks, the compliance with the IOSCO Principles for Financial Benchmarks (the "***IOSCO Principles***") and the application of a regulatory framework that is proportionate.[6]

We agree that alternatives to Libor should be encouraged. In this context, the Review should note that some viable alternatives to Libor are available today.[7] Libor rates, which are based on the cost of unsecured credit, contain a credit risk component that makes them ill-suited references for financial transactions that should not contain a comparable credit risk component, e.g., most derivatives and secured transactions. The use of alternative benchmarks that are based on real transactions that represent a financial institution's risk-free cost of lending should therefore play an important role as interest rate benchmarks and will help ensure the soundness of the FICC markets going forward. We agree with the view of the Financial Stability Board's Official Sector Steering Group that "shifting a material proportion of derivative transactions to a risk-free rate would reduce the incentive to manipulate rates that include bank credit risk and would reduce the risks to bank safety and soundness and to overall financial stability."[8]

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[3] FEMR CD 1.4 Principles guiding the Review's work
[4] FEMR CD 5.3 Benchmarks.
[5] FEMR CD 1.2 Misconduct.
[6] FEMR CD Q21-Q26.
[7] Markit provides detailed daily information about collateral posted with tri-party managers against USD cash loans. US tri-party repo transactions are sourced through BNY Mellon Broker-Dealer Services and then aggregated and anonymised.
[8] Reforming Major Interest Rate Benchmarks, July 14, 2014, at 11, available at http://www.financialstabilityboard.org/wp-content/uploads/r_140722.pdf

In regards to the broader topic of benchmark regulation, we urge the Review to recognize that, amongst the large number and variety of existing benchmarks and indices, the "IBORs" represent a unique case. This is because they are systemically important benchmarks which provided some market participants with strong incentives for manipulation and the ability to do so because of their often flawed fixing process, whilst the parties involved in administering and contributing to Libor were not exposed to specific regulatory oversight or standards. The combination of these features contrasts with the vast majority of indices and benchmarks.

The Review should also consider the significant negative impact that imposing overly demanding regulatory requirements on a broad variety of benchmarks could have on transparency and risk in financial markets. Specifically, the cost of ever increasing compliance burdens and concerns about potential liabilities can deter firms from contributing data to index providers. It is therefore imperative that any requirements imposed on submitters to benchmarks are not overly burdensome and are applied in a proportionate manner. Otherwise there will be a heightened risk that submitters choose to discontinue their submissions to various services. If fewer firms contributed to benchmarks, the transparency benefit they provide would be reduced since their utility as a representative of a market is lowered with fewer submissions; at the same time the risk of manipulation would increase since remaining contributors to these indexes have an increased ability to affect them.

As regulators look to reduce the risk of manipulation of benchmarks any regulatory framework should hence be carefully calibrated based on several relevant factors. Such factors should include (a) the systemic relevance of the benchmark, (b) the existing extent of oversight and/or the controls and procedures already established by the benchmark administrator, (c) the incentive as well as the ability of contributors to manipulate the benchmark, and (d) the availability of alternative benchmarks and the ability of users to switch to those.

Markit has been actively engaged in the discussions about the regulation of benchmarks in Europe and elsewhere. As an administrator of indices across regions and asset classes we have implemented the IOSCO Principles for Financial Benchmarks[9] and our relevant indices are now in compliance with them.[10] In the process we have encountered some specific challenges that, we believe, the Review should take into account when considering the application of relevant regulation in the UK:

a) Administrators' consent

The IOSCO Principles and the proposed European Benchmark Regulation[11] contain a broad definition of "benchmark" including any index that is used as reference to determine the price, value or performance of a financial instrument. In particular in cases where index levels are published, the use-based prong of the benchmark definition creates a risk that the administrator does not know whether its index is a benchmark or not. Any regulatory regime should therefore provide the administrator with the authority to determine whether one of its indices would come into scope of the regulation based on its use. Specifically, any determination whether an index is to be regarded as a "benchmark" should be based on the Administrator (a) being *aware* of the index being used as a benchmark and (b) providing explicit *consent* to this use. Without the element of consent any third party, by using a published index to determine the price, value or performance of a financial instrument, could force an administrator to operate an index as a regulated benchmark, or, in the extreme, even unwittingly make an index provider a regulated benchmark administrator.[12]

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[9] IOSCO Principles for Financial Benchmarks Final Report. July 2013.

[10] Markit announced that it will administer its benchmarks in compliance with the IOSCO final report on principles for financial benchmarks on 14 July 2014. Please see http://www.markit.com/Company/Media-Centre/Markit-indices-confirms-compliance-with-Iosco-principles for additional information.

[11] Committee on Economic and Monetary Affairs proposal for the regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts. 11 December 2014.

[12] In the context of the European Regulation of Benchmarks we note that the original proposal by the EU Commission contained the concept of provision of consent by the Benchmark Administrator. However, it was not retained in the EU Council version.

b) Code of conduct for submitters

As explained above, regulations for benchmarks must be proportionate and appropriate as to not unnecessarily incentivising submitters to discontinue their contributions. However, requiring benchmark administrators to impose a code of conduct on submitters, particularly if it was to be "legally binding", can cause significant problems for submitters. Further, administrators are generally not in a position to "ensure" that submitters comply with a code of conduct. If regulators want the provision of benchmarks to continue any requirements in relation to a code of conduct must allow for ease of implementation and avoid imposing overly burdensome requirements. Specifically, a binding code of conduct should be required only for Critical Benchmarks. For other relevant benchmarks, administrators should only be required to make reasonable efforts to receive confirmation of compliance with the code of conduct from their submitters. In case of complaints regulatory authorities should be able to require an audit report from administrators or submitters.

c) Intellectual property rights

We believe that regulators must balance the need for transparency with the protection of the intellectual property rights of benchmark administrators. The IOSCO Principles require an explanation regarding the benchmark determination; however it is important that administrators be able to protect their intellectual property. We note that the Draft Report of the European Parliament[13] provides that, where the publication of the benchmark methodology conflicted with IP law, it should be provided to the relevant Competent Authority.[14]

d) Compliance with IOSCO Principles

Over the last year, the FCA actively encouraged UK-based benchmark administrators to comply with the IOSCO Principles. We welcome this initiative and the helpful feedback that the FCA provided in this context. We believe that the FCA, but also other regulators globally, should continue reminding financial benchmark administrators of IOSCO's call for compliance with its Principles. The continued engagement of regulators and the upcoming publication of IOSCO's report on administrators' compliance with its Principles will be helpful in this respect.[15] We believe that such approach will be instrumental to creating a level playing field between competing benchmark administrators around the globe.

Product standardization and electronic trading[16]

The CD states that greater use of standardized exchange-traded and centrally cleared FICC derivative products would be desirable from a regulatory perspective.[17] It also asks whether further measures are necessary to achieve this goal.

As a provider of middleware and connectivity services[18] for OTC derivatives across asset classes and regions, we note that the standardization of FICC derivatives has progressed very significantly over the last several

[13] Committee on Economic and Monetary Affairs proposal for the regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts. 11 December 2014.
[14] "Where such publication would not be compatible with applicable intellectual property law, the methodology shall be made available to the relevant competent authority." Article 7b Transparency of Methodology. Committee on Economic and Monetary Affairs proposal for the regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts. 11 December 2014.
[15] In response to Q25.
[16] "Should standardisation be contemplated across a broader range of fixed income products?" FEMR CD Q6.
[17] FEMR CD Section 1.3 Objectives of the Review.
[18] MarkitSERV, a wholly owned subsidiary of Markit Group Limited, provides a single gateway for OTC derivatives trade processing. The company offers trade processing, confirmation, matching, and reconciliation services across regions and asset classes, including

years, be it in the aspects of product documentation, processing or economics. Whilst product and processing standardization has been established across asset classes and product categories, economically standardized derivative products are available (e.g., in the form of "MAC" swaps[19]) and are used by market participants where they regard those products as appropriate for their needs. Consistent with the Review's comments[20] we believe that the changes in market structure that are already underway, including the introduction of clearing mandates around the globe,[21] are likely to facilitate additional product standardization in any case. A further regulatory push for product standardization might therefore not be necessary at this time.

Markit has been actively involved in the introduction of trading requirements for OTC derivatives in various jurisdictions. We believe that the introduction of SEF trading under the CFTC's requirements[22] in particular has demonstrated that an overly aggressive trade execution requirement[23] can create significant risks, including the fragmentation of liquidity pools and a reduced degree of competition.[24] In some jurisdictions, execution of OTC derivatives trading now seems increasingly concentrated on a small number of venues,[25] resulting in a lack of choice, potentially higher prices for users, and increased systemic risk.[26] The Review should also consider that such concentration might result in vertical integration in the future, which may further increase costs for market participants and systemic risk without commensurate benefit. In order to avoid the fragmentation of the markets with negative impact on liquidity that was caused by the introduction of the SEF trading mandate, we believe that international harmonization of the trade execution rules is needed. A harmonized global approach should take into account the unique liquidity characteristics of each market and seek to create a regulatory regime that promotes liquidity formation and competition.

Finally, the Review should explicitly recognise the valuable role that providers of middleware services[27] play for market participants. FEMR defines "fair" markets as including, among other things, markets that "demonstrate

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interest rate, credit, equity, and foreign exchange derivatives. MarkitSERV also connects dealers and buy-side institutions to trade execution venues, CCPs, and trade repositories. Please see www.markitserv.com for additional information.

[19] ISDA and SIFMA developed a new interest rate swap contract structure with pre-defined, market-agreed terms. These Market Agreed Coupon ("***MAC***") contracts have been designed to promote liquidity and enhance transparency in IRS trading. ISDA press release. 24 April 2013.

[20] The Review acknowledges that market structure changes in FICC that include a move towards greater use of standardised exchange-traded and cleared derivatives are already underway. FEMR CD 1.3 Objectives of the Review.

[21] IOSCO published an information repository for central clearing requirements for OTC derivatives which provides consolidated information on the clearing requirements in different jurisdictions. The repository sets out central clearing requirements on a product-by-product level and includes clearing requirements from the US, Japan, China, Korea, India and Shanghai.

[22] Various Made Available to Trade determinations: *See* Javelin Determination of Made Available to Trade of certain Interest Rate Swaps made Pursuant to Parts 37 of the Rules of the Commodity Futures Trading Commission (Submission No. 13-06R) (Oct. 31, 2013); MarketAxess SEF Corporation Made Available to Trade ("MAT") Submission of Certain Credit Default Swaps (Oct. 30, 2013); TW SEF LLC- Self-Certification {or Swaps to be Made Available to Trade (Oct. 28, 2013); Made Available to Trade ("MAT) Submission of Certain Interest Rate Swaps ("IRS") pursuant to CFTC Regulation 40.6 (trueEX LLC submission #2013-14) (Oct. 21, 2013).

[23] Under CFTC rules, transactions subject to the CFTC's trade execution requirement, i.e. "Required Transactions," must be executed in an order book (Order Book) or an RFQ system in which a request for a quote is sent to three participants operating in conjunction with an Order Book (RFQ System). 17 C.F.R. 37.3(a) (2), 37.3(a) (3), and 37.9(a) (2).

[24] See CFTC Commissioner Christopher Giancarlo, Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank, Jan. 29, 2015, at, 3, available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/sefwhitepaper012915.pdf ("[T]here is a fundamental mismatch between the CFTC's swaps trading regulatory framework and the distinct liquidity and trading dynamics of the global swaps market. It explains that the Commission's framework is highly over engineered, disproportionately modeled on the U.S. futures market and biased against both human discretion and technological innovation. As such, the CFTC's framework does not accord with the letter or spirit of the Dodd-Frank Act.").

[25] See, for example, A Review of 2014 U.S. Swap Volumes, Amir Khwaja, Clarus, http://www.clarusft.com/a-review-of-2014-us-swap-volumes/ which finds that the Top 4 venues had 88% market share in December 2014.

[26] See CFTC Commissioner Christopher Giancarlo, Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank, Jan. 29, 2015, at 3, ("[T]he CFTC's rules carve swaps trading into numerous artificial market segments, fragmenting markets domestically. This fragmentation has exacerbated the already inherent challenge in swaps trading – adequate liquidity – and thus is increasing market fragility and the systemic risk that the Dodd-Frank reforms were predicated on reducing.").

[27] E.g., electronic confirmation and matching, post-trade notices of execution, post-trade affirmation and submissions to clearing, allocations, and regulatory and risk reporting.

sufficient transparency and open access."[28] The Review elaborates that "open access" can be provided "either directly or through an open, competitive and well-regulated system of intermediation."[29] We believe that "open markets" are markets that provide non-discriminatory access also to middleware service providers and the customers that use them. MarkitSERV, regulated by the FCA, and other middleware service providers play a critical role as intermediators in the derivatives market, for example in support of trading in products that are traded bilaterally or on venues, e.g., OTC or exchange-traded non-standard derivatives. The features of custom, OTC, non-standard derivatives make post-trade processing and trade capture into a financial institution's risk systems costly and challenging, particularly if each financial institution had to build its own capability to process these transactions. Middleware can scale post-trade processing, making it easier for market participants to process, understand, and hedge risk. Because of their scale and expertise, middleware is also well equipped to handle the post-trade processing of more standard, exchange-traded derivatives. Similarly, middleware can provide market participants and trading venues with a single point of access to clearing venues, enhancing the range of cleared, standardized products accessible to market participants and trading venues, as well as promoting competition in the market for clearing services.

That said, we recommend for the Review to apply heightened scrutiny of discriminatory actions when a clearing or trading venue appears to have an anti-competitive motivation to discriminate against middleware providers and/or middleware customers, e.g., when such market infrastructure has a competing middleware service or appears to discriminate against middleware in order to protect a dominant incumbent position in an asset class.[30] Robust protections on competition and express protections for middleware service providers and their customers will reduce barriers to entry and level the playing field for trading and clearing venues alike, thereby fostering competition in the marketplace.[31] Similarly, operational requirements for accessing a clearing or trading venue should be applied uniformly and non-discriminatorily whether a customer uses middleware or not.

Transparency

In defining 'fair' the CD states that "there should be sufficient transparency, giving participants common access to the information necessary to allow them to verify that rules and practices are applied consistently."[32]

Our experience has shown that, in order to create useful transparency in financial markets one needs to consider all available sources of information. This is particularly true for financial instruments that trade mainly over-the-counter and infrequently. We agree that transaction prices can be useful inputs into the valuation of financial products. However, they often need to be used with caution, for example because a range of unknown factors, such as option exercises or package transactions, can impact the transaction price. Further, given that many instruments in the non-equity markets trade only infrequently, transaction prices will simply not be available for many instruments on a regular basis. Finally, FEMR should note that transaction information in the non-equity markets will be available under the upcoming MiFID II requirements[33] in any case. In conclusion, we believe that no immediate action is required by the Review in relation to making transaction prices available.

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[28] FEMR CD Executive Summary.
[29] Id.
[30] In the latter scenario, a dominant clearing or trading venue may be motivated to eliminate the role of middleware in the asset class it dominates because middleware's value is in its ability to facilitate clearing and trading in different venues. In asset classes where middleware plays little or no role, the ability of new trading or clearing venues to compete with a dominant incumbent is reduced because the middleware pipeline through which liquidity could be transferred would be effectively closed.
[31] Add reference
[32] FEMR CD 3.3 Defining 'fair'.
[33] "Market operators and investment firms operating a trading venue shall make public the price, volume and time of the transactions executed in respect of bonds, structured finance products, emission allowances and derivatives traded on a trading venue. Market operators and investment firms operating a trading venue shall make details of all such transactions public as close to real-time as

The Review states[34] that information asymmetries might arise where one party is in possession of a better data set or where one side provides a price, which might be particularly pronounced in thinly traded markets. It comments that such information asymmetries can make the process of price discovery less efficient and that appropriate transparency mechanisms should be in place to reduce information asymmetries. In this context, the Review should take into account the mechanisms that already exist and are provided commercially to market participants. For example, similar to numerous other, competing providers, Markit offers transparency-creating products for both buy-side and sell-side participants across a range of asset classes and products, both on a pre- and on a post-trade level. Specifically, Markit Pricing Data provides robust coverage across bonds, CDS and loans pricing as well as equity volatility data and securities lending data for stocks and bonds. Further, Markit Portfolio Valuations is an industry-validated, fully hosted service that provides independent valuations and risk measures for vanilla and exotic derivatives, private equity investments, structured notes and cash products to buy-side participants. We offer full transparency into our valuation methodologies and inputs and apply rigorous cleansing algorithms to our data to ensure its quality.

Market manipulation and surveillance[35]

The CD states that market participants reported difficulties distinguishing between legitimate trading activities and inappropriately front-running or market manipulation.[36]

We believe that some of these difficulties might originate from an excessive focus on identifying specific techniques of manipulation on an ad hoc basis instead of employing a systematic top-down approach to spotting inappropriate trading behaviour. Our experience has shown that the former approach often fails, either because one does not manage to identify the specific technique that was applied in the situation[37] or by delivering false positives. We therefore recommend for market surveillance to focus on identifying the common *indicators* of manipulation, market abuse and rogue trading instead of aiming at identifying the specific techniques that might have been employed. This objective can be best achieved by analysing a trader's profit and loss record, and, specifically, by identifying and analysing the activity of traders that are unusually successful. Our experience[38] has shown that such approach often results in successfully identifying market abuse and rogue trading, regardless of which technique of inappropriate trading behaviour it was based on.

We further note that market surveillance is often performed on a manual and ad hoc basis, e.g., by focusing the analysis on activity around specific market-impacting events. We believe that it is possible and, given the large and increasing numbers of transactions that many participants execute in financial markets and the variety of techniques of market abuse and rogue trading that can be employed, also necessary to perform such surveillance on a comprehensive and automated basis across all transactions.

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technically possible." Article 10 of MiFIR: Post-trade transparency requirements for trading venues in respect of bonds, structured finance products, emission allowances and derivatives.

[34] "Concentration in some FICC markets is relatively high on both the sell and the buy-side, and in some cases firms have also engaged in horizontal or vertical integration – raising potential conflicts of interest and concerns about information asymmetries." FEMR CD 4.2.

[35] FEMR CD Box 7 Reported uncertainties over FICC market practices.

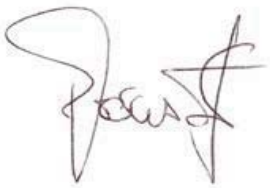
[36] FEMR CD Q28.

[37] Sometimes this technique might not even be identified as "rogue trading" yet.

[38] Markit Academy, Trading Hub, provides profiling and market abuse / rogue trading surveillance metrics to banks, regulators, fund managers and exchanges. To date it has analysed over 2bn trades executed by 6mm traders globally for several markets regulators.

We hope that our above comments are helpful to the Review. We would be more than happy to elaborate or further discuss any of the points addressed above in more detail. In the event you may have any questions, please do not hesitate to contact us.

Yours sincerely,



Marcus Schüler
Head of Regulatory Affairs
Markit
marcus.schueler@markit.com