

# NEW ZEALAND FINANCIAL MARKETS ASSOCIATION

## BENCHMARK ADMINISTRATION PROJECT SCOPE

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## OVERVIEW

### 1. Project Background and Description

**i** The NZFMA has been responsible for the administration and calculation of the key New Zealand Financial Benchmarks since it took over calculation responsibility from Reuters in 2008, initially using the services provided by Australian Financial Markets Association and subsequently via the development of NZFMA's NZdata Service.

During its time as Benchmark Administrator, the NZFMA has worked with its members via the Rates Committee to evolve these benchmarks to comply with global best practice. Initiatives such as the use of transactions to support the calculation of BKBM, the publishing of all transactions in an effort to provide full transparency and the establishment of a 'Benchmark Oversight Committee' to provide appropriate governance have contributed to a market environment where no formal issues of misconduct have arisen.

As the global regulatory environment for benchmarks has been plagued by many misconduct events, Regulators in the major economies have moved to regulate benchmark administrators using the IOSCO Principles for Benchmarks as a guideline for best practice. As a result of this global regulation, benchmarks that exist in third countries have been captured to an extent that, unless these third country benchmarks comply with global regulation, their use by those regulated entities could be restricted. This in turn could have a detrimental impact on the ability of banks to fund and corporate/investment institutions to hedge.

This regulatory landscape has led the New Zealand Financial Markets to its current position with regard to Financial Benchmarks. In order to comply with global benchmark regulation and especially European Union Benchmark Regulation (EU BMR), the New Zealand Benchmark Administration process must meet an equivalence standard prescribed by the European Council before it can be registered as a EU compliant benchmark. In simple terms this means that New Zealand benchmarks must meet the IOSCO Principles for Benchmarks and that there is a 'Competent Authority' based in New Zealand that is administering a Licensing regime for Benchmark Administrators'.

That now leads me to describe the project that the NZFMA is about to embark on. In order to comply with the IOSCO Principles for Benchmarks and to meet the principles that will be enforced through the proposed New Zealand Benchmark Licensing Regime, the Financial Benchmark Administration processes need to be structured in a way that mitigates to the most practical degree, any conflicts that are identified with that proposed structure.

Benchmark administration structural considerations need to take into account the desire by regulators to ensure that any conflicts of interest be addressed and managed while at the same time ensuring that the benchmark administration process can be conducted within the constraints imposed by the nuances of the local market. Benchmark administration models that have been adopted around the world vary widely and it is clear that not one model suits all. One thing that is a constant is that conflicts of interest do occur in all models and the key issue is how these conflicts are addressed.

The NZFMA in its capacity as existing benchmark administrator is best placed, in an absence of qualified alternatives, to embark on an assessment of the most appropriate benchmark administration (BA) structure for the New Zealand Financial Markets. Clearly the NZFMA has a commercial benefit in retaining an interest in the BA function. However, taking into account the NZFMA's unique knowledge and experience derived from managing the evolution of benchmark design in NZ, it needs to play a critical role in this assessment.

As such, taking a pragmatic approach that draws on the NZFMA's knowledge, whilst managing the conflicts through the assurances provided by our external auditors and an independent benchmark oversight committee, the NZFMA will conduct this assessment and make its recommendation.

## 2. Project Scope

**i** The project scope will focus on the current benchmark administration process with the NZFMA as BA and identify the conflicts that currently exist operating that model. Given the relative success using this model it would seem that this approach would be a good starting point so as to ensure we do not throw the baby out with the bath water. Once this assessment has been completed and the conflicts identified, we will also conduct a strengths and weakness assessment of that model identifying the most practical conflict mitigation processes.

Once we have completed this inward-looking assessment, the project will then focus on alternative BA models that operate around the world and, in each case, we will conduct a strengths and weaknesses assessment. Given that most alternative models have been established to address conflicts that previously existed, it is not deemed necessary to conduct a conflict assessment.

To ensure that we have an appropriate level of assurance that our assumptions, structure analysis, conflict management and conclusions are sound and fit within the regulatory confines of the New Zealand Financial Markets, we will employ the resources of Simon Jensen from Buddle Findlay, who has significant experience in this area, to assist our efforts.

Subsequent to this detailed model assessment, the NZFMA will propose its preference and seek assurance from our external benchmark auditor that our preferred model meets IOSCO benchmark principles and mitigates any conflicts identified.

In summary, the project will:

- Complete a thorough assessment of our current model and identify conflicts that exist.
- Propose how existing conflicts identified with the existing model might be mitigated.
- Introduce different Benchmark Administration models that are in place or proposed around the world.
- Identify those models that would potentially work given the market constraints that exist in New Zealand.
- Identify the pros and cons associated with each model.
- Seek an assurance from Buddle Findlay that our model selection criteria considers all relevant regulations and the preferred model complies with relevant regulations.
- Seek a formal assurance from our external benchmark auditor, Deloitte, that our preferred model meets IOSCO Benchmark Principles and mitigates any conflicts to an acceptable level.
- Recommend the preferred model for approval by the BOC.

## 3. High-Level Requirements

**i** The new proposed benchmark administration structure must deliver the following:

- Continued calculation and distribution of all existing and proposed financial benchmarks.
- Attainment of both local and international benchmark regulatory requirements.

## 4. Deliverables

**i** The key deliverables from this project are as follows:

- The Benchmark Administrator must be resident in New Zealand.
- Conflicts of interest identified, must be mitigated to the satisfaction of our external benchmark auditor, conduct regulator and BOC.
- The proposed structure must demonstrate that it has appropriate staff and financial resources to perform its operational responsibilities.
- The proposed structure must be able to meet the obligations imposed by the new Benchmark Administration Licensing Regime.

- The proposed structure must ensure benchmark compliance with the IOSCO Principles for Benchmarks.

## 5. Stakeholders

**i** Stakeholders with a key interest in the outcome of this project are as follows:

1. **NZFMA Board** – The Board of the NZFMA represent their member institutions. The sound functioning and availability of accurate and robust benchmarks are critical to banks' business. Their support for the participation from staff at the relevant Committees ensures that market requirements for benchmarks and the monitoring of conduct related issues within the underlying markets is provided for.
2. **Financial Markets Authority** – The FMA, being the conduct regulator for wholesale financial markets, has a critical interest in ensuring that fair and transparent market activity underlies the establishment of financial benchmarks. They are represented as observers on the Benchmark Oversight Committee and will enforce the new benchmark administration licensing regime.
3. **Reserve Bank of New Zealand** – The RBNZ, being the prudential regulator, has a critical interest in having sound financial markets. Financial benchmarks are critical to the operation of financial markets and as such they have a keen interest in their operation.
4. **Ministry of Business, Innovation and Employment** – MBIE are responsible for ensuring the appropriate legislative framework is put in place for New Zealand to meet its local and international regulatory obligations. They have been instrumental in liaising with the European Commission to ensure NZ financial benchmarks meet equivalence criteria.
5. **Institute of Finance Professionals, New Zealand** – INFNZ membership includes both Corporations and Investment Institutions that use financial products that reference financial benchmarks. They have a key interest in the maintenance of robust and transparent benchmark processes in New Zealand.

## 6. Specific Exclusions from Scope

**i** The NZFMA's other activities are excluded from the scope of this project, namely education, accreditation, advocacy on behalf of its members and its work with charities.

## 7. Implementation Plan

**i** The project will be broken down into three stages. This is to ensure that external dependencies outside of the control of the NZFMA does not unnecessarily delay the project. Project stages are as follows:

1. Stage 1 – This stage will include a thorough assessment of our current structure focusing on the identification of conflicts. We will also include in this phase of the project the analysis of other models that exist internationally and the completion of the strengths and weaknesses of each.
2. Stage 2 – This stage will focus on analyzing all of the information gleaned from Stage 1 and, working closely with our legal advisor at Buddle Findlay, we will compile our recommended structure, taking into consideration the obligations that will need to be met as part of the Benchmark Licensing Regime.
3. Stage 3 – This final stage will include attaining stakeholder feedback on the proposed structure and, once completed, the commissioning of an external audit by Deloitte on the final benchmark administration structure and processes. The stakeholder communication will involve presenting our preferred model, critiquing and modifying as necessary to come up with the final solution.

## 8. High-Level Timeline/Schedule

**i** Project phase completion timelines are as follows:

1. Stage 1 – Information Gathering & Analysis - Targeted for completion by the end of August, mid September.
2. Stage 2 – Development of Preferred Structure – Targeted for completion by mid to late October.
3. Stage 3 – Stakeholder Communication and Audit – Targeted completion by mid December.

## APPROVAL AND AUTHORITY TO PROCEED

We approve the project as described above, and authorize the team to proceed.

Name	Title	Date
Paul Atmore	Chair BOC	25 July, 2019
Graeme Liddell	Chair NZFMA	25 July, 2019

<b>Approved By</b>	<b>Date</b>	<b>Approved By</b>	<b>Date</b>
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