



Discussion Paper on Draft Code of Conduct for Index Providers

Objective

To solicit the comments/views from market participants on the issue of code of conduct for index providers to enhance greater level of transparency, increased disclosure requirements and to provide broad framework for Index Providers while managing/maintaining Indices.

Background

The International Organization of Securities Commissions (IOSCO) published a report in July 2013, proposing a framework of standards for financial benchmarks (or indices) based on international best practices. The framework promotes reliability and independence of benchmark administration and addresses governance, quality, transparency and accountability issues. IOSCO report does not expect a one-size-fits-all method of implementation of the framework, nor does it restrict an administrator from adopting its own unique methodologies or adapting the methodologies to changing market conditions. IOSCO adherents are directed to either comply with the IOSCO principles or explain any non-compliance.

Based on the IOSCO report, SEBI constituted sub-group comprising of expert from various sections of market participants to suggest a framework for regulation of Index Providers in India. The Sub-group has prepared a Code of conduct for Index Providers (“Code”) broadly based on the IOSCO framework for adoption in India. While the Code sets out uniform expectations, it does not expect a one-size-fits-all method of implementation by Index Providers. Indeed, given the large universe of indices and possible impact on market dynamics, implementation of the Code may not be identical for each Index; rather, these would be broad standards that could be met in different ways, depending on specificities of each Index. Application of these principles should be proportional to the size and risks posed by each Index and/or Index Providers and the index-setting process.

The purpose of the proposed Code is to set forth standards to be adopted by the Index Providers in order to ensure the high quality and integrity of the Indices administered, maintained or calculated by the Index Providers.

Code (“Code”) for Index Providers

This Code prescribes a framework of standards that Index Providers should follow to promote the reliability of the Index Administration Process and to address governance, quality, transparency and accountability issues and is applicable to Indices (as defined herein).

A. Applicability of Code of Conduct:



भारतीय प्रतिभूति और विनिमय बोर्ड Securities and Exchange Board of India

“Index Providers providing Administrative services (such as determining Index composition, governing an Index methodology and/ or otherwise providing index maintenance services) in India for Indian markets are required to adhere to the proposed Code of Conduct.

Foreign entities from jurisdictions with any type of membership of Financial Action Task Force (FATF), can provide Administrative services (such as determining Index composition, governing an Index methodology and/ or otherwise providing index maintenance services) for Indian indices where such indices are being used as the basis of Products in India. Such entities are required to adhere to the proposed Code of Conduct”.

B. Governance

An Index Provider should have appropriate governance arrangements in place in order to protect the integrity of the Index Administration Process, mitigate conflicts of interest, and segregate those responsible for index governance from those responsible for commercializing the indices by implementing appropriate firewalls and employing separate reporting lines for each function.

1. Overall Responsibility of an Index Provider

An Index Provider should have primary responsibility for all aspects of its Index Administration Process such as the development, calculation and maintenance of an Index and the establishment of credible and transparent governance, oversight and accountability procedures. Regardless of the particular structure for Index Administration, an Index Provider should be the entity with overall responsibility for the integrity of its Index. An Index Provider jointly owning an Index with another entity should establish clear roles and responsibilities for each party and design clear standards for its activities to facilitate delivering the Index according to the Index Provider’s Methodology.

2. Oversight of Third Parties

Where activities relating to the Index Administration Process are undertaken by parties other than the Index Provider or its affiliates, an Index Provider should have in place an appropriate framework to monitor such third parties’ activities with the objective of complying with this Code. The framework should include clearly defined written arrangements setting out the roles and obligations of the parties involved. This shall not apply in relation to a third party from whom an Index Provider sources data if that third party is a Regulated Market or Exchange.

3. Conflicts of Interest

The Index Provider should have policies and procedures to manage conflicts of interest and to protect the integrity and independence of the various functions performed in connection with administering its Indices. An Index Provider should document, implement and enforce, as far as practicable, these policies



भारतीय प्रतिभूति और विनिमय बोर्ड Securities and Exchange Board of India

and procedures for identification, disclosure, management, mitigation or avoidance of conflicts of interest. The Index Provider should have policies that prevent personal interests or business connections from compromising the performance of its functions, put in place effective procedures to control the exchange of information among staff engaged in activities involving any potential risk of conflicts of interest, require its employees to comply with applicable laws and regulations and protect confidential and material non-public information. This policy should apply to individuals responsible for any aspect of the oversight function with respect to the Indices as well as those individuals engaged in the day-to-day governance and operations of calculating and maintaining Indices.

Policies should:

- Specify who has access to Sensitive Information
- Specify processes for deployment of a firewall for Sensitive Information
- Specify trading restrictions and pre-clearance requirements for securities impacted by pending index changes for appropriate personnel both of which should adhere to applicable laws.

4. Control Framework

An Index Provider should have in place a control framework for calculating, maintaining and distributing the Index. The control framework should be documented; and, upon request, made available to the relevant Regulatory Authorities as appropriate on need to know basis. The control framework should have an effective whistle-blowing mechanism in order to facilitate early awareness of potential misconduct. The Control framework should include the following components:

- Policies and procedures as prescribed in Section B-3.
- Quality of the Index and Methodology: The Index Provider should have in place robust processes and a Methodology for calculating and maintaining the Index. As set forth in Section C, the methodology document should include a scenario where discretionary judgment could be exercised in connection with rebalance decisions and/or the revision of constituents within indices.
- Robust mechanism to ensure clear accountability and effective complaint management.
- Robust infrastructure for management of operational risk: An Index Provider should have a sound framework for documenting, maintaining and testing business continuity and recovery procedures.
- Whistle-blowing mechanism: A whistle-blower policy should be made available to each employee. The objective of the policy is to encourage and support the making of disclosures by employees who observe any unethical practice or grave misconduct.
- The Index Provider should provide training to all its employees on ethics and conflicts of interest on a periodic basis.
- A framework addressing the protection of Sensitive Information and trading restrictions mentioned in Section B-3 shall be in place.



5. Internal Oversight

An Index Provider should have an oversight function for all aspects of the Index Administration Process. The oversight function should be separate and distinct from the direct day-to-day process of Index calculation and maintenance and, as such, be independent of the actual Index calculation process.

The oversight function should be entrusted to individuals who are experienced and knowledgeable in the subject matter.

The oversight function should Include:

- Review of any need for change in the Index design or computation Methodology due to changes in market dynamics or any other reason. It should evaluate the proposed approach for the change, if any, along with its impact on the existing Subscribers.
- Overseeing results of audits and direct implementation of remedial actions recommended by those audits
- Review of procedures for cessation of an Index.
- Overseeing standard procedures followed in the exercise of Expert Judgment.
- An Index Provider should periodically review the conditions in the underlying Interest which the Index measures to determine whether the Interest has undergone structural changes that might require changes to the design of the Methodology.

C. Quality of the Index

6. Index Design

An Index design should take into account factors which result in a representation of the Interest that the Index seeks to measure. The design of the Index should also seek to eliminate factors that the Index Provider believes might result in a distortion of the price, rate or value of that Index.

7. Data Sufficiency

To calculate an Index, an Index Provider should use data that, in its view, considering the availability of data, are sufficient to represent the Interest measured by the Index. As far as reasonably practicable, such data should be based on observable transactions that are traded or reported on Regulated Markets or Exchanges. This does not restrict an Index Provider from constructing Indices based on non-transaction data which are anchored by actual market activity.

8. Data Inputs

An Index Provider should establish and make publicly available clear guidelines regarding the data inputs and how such data are used for the calculation and maintenance of an Index. An Index Provider should use inputs



भारतीय प्रतिभूति और विनिमय बोर्ड Securities and Exchange Board of India

consistent with the approach to ensure quality, integrity and continuity of its Index calculations and maintenance as set out in the Index Methodology.

9. Data Submitters and Submissions

An Index Provider may obtain Submissions from across a wide universe of market segments. The Index Provider should perform due diligence on its Data Submitters and provide Non-regulated Data Submitters with a Data Submitters Code of Conduct which should address quality, oversight, conflicts of interest management, record-keeping and whistleblowing.

10. Transparency of Index Calculation and Maintenance

An Index Provider should make the Methodology documents publicly available to facilitate an understanding of how the Index seeks to measure the Interest and how the Index is calculated and maintained. The Index Provider should put in place clear guidelines in cases when the Index Provider uses Expert Judgment to maintain an Index.

In order to bring about the transparency in the dissemination of information about changes to Index constituents, an Index Provider, should provide clear guidelines specifying the timing of announcements for changes to Index constituents (e.g. replacement of constituents in the Indices) in its Methodology document.

D. Quality of the Methodology

11. Content of the Methodology

An Index Provider should document and make publicly available the Methodology used for Index calculation and maintenance to allow an understanding of how the Index is derived and to assess its representativeness, relevance and appropriateness as a reference for financial instruments.

In its Methodology document, an Index Provider, in order to bring about transparency in the dissemination of information about Index constituent changes (adds, deletions or replacements) in the indices, should provide for clear guidelines addressing time frames for changes to Index constituents which are designed to allow sufficient implementation time.

12. Changes to the Methodology

An Index Provider should seek market feedback as appropriate for significant changes to the Index Methodology. An Index Provider should review the Methodology for an Index on a periodic basis and may propose to make changes, if necessary, to adhere to its objective. Wherever applicable and practical, the Index Provider should consult and discuss the change in Methodology with stakeholders (e.g., Market Participants, Subscribers) before implementing the change in Methodology. The Index Provider should also



भारतीय प्रतिभूति और विनिमय बोर्ड Securities and Exchange Board of India

provide advance notice of the implementation of the proposed change in the Methodology.

13. Transition

An Index Provider should have policies and procedures to address the need for possible cessation of an Index. These policies and procedures may be proportional to the estimated impact on Market Participants and Subscribers. The Index Provider should provide reasonable notice and inform Subscribers about the possible cessation of an Index. Wherever reasonably practical and if required by the Subscriber for the Index that is to be discontinued completely, the Index Provider should maintain the Index for a reasonable period of time. The Index Provider, if feasible, should also provide an alternative Index within a reasonable timeframe.

14. Internal Controls over Data Collection

An Index Provider should maintain appropriate internal controls to address the processes for selection of data sources and Data Submitters, for data collection, and for the protection of data integrity and confidentiality, including the maintenance of appropriate firewalls.

E. Accountability

15. Complaints Procedure

An Index Provider should establish and make publicly available, complaints redress policy by which Subscribers may submit complaints concerning whether a specific Index is representative of the underlying Interest it seeks to measure, application of the Methodology to a specific Index calculation and other decisions in relation to an Index Administration Process.

16. Audits

An Index Provider should arrange for periodic review and report on its adherence to the stated criteria, including the Methodology criteria. For this purpose, the Index Provider should use an independent auditor with appropriate experience and capability. The Index Provider should make available on its website such auditor's certification no less frequently than bi-annually for access by its market participants, subscribers or the Regulatory Authorities.

17. Audit Trail

The Index Provider should retain written records and Audit Trails for five years.

18. Reporting Requirement

Index providers are required to submit a monthly/ quarterly report providing details regarding compliance with the code of conduct to SEBI.



F. Licensing Indices in foreign jurisdictions

19. While licensing indices in foreign jurisdictions index providers are required to follow either of the following broad parameters;

Option- A

“Any new license of Indian Indices by an Indian Index provider in other jurisdiction will be subject to meeting all of the following criteria for the Jurisdiction/Stock Exchange:

- ❖ Membership of Financial Action Task Force (FATF).
- ❖ Jurisdictions which have not been identified by FATF as jurisdictions with strategic AML/CFT deficiencies including its member countries.
- ❖ Jurisdiction where MoU is signed for information sharing, information exchange etc.
- ❖ The proposed counterpart Exchange shall be recognized Stock Exchange with minimum 5 years of track record in business.
- ❖ Any other condition as may be specified.

Or

Option B

“Any new license of Indian Indices by an Indian Index provider in other jurisdiction will be subject to meeting the following criteria for the Jurisdiction/Stock Exchange:

- ❖ Any type of membership of FATF including member, affiliated members and countries having observer’s status. Foreign jurisdiction is defined as under;

“foreign jurisdiction” means a country, other than India, whose securities market regulator is a signatory to International Organization of Securities Commission’s Multilateral Memorandum of Understanding (IOSCO’s MMOU) (Appendix A signatories) or a signatory to bilateral Memorandum of Understanding with the Board, and which is not identified in the public statement of Financial Action Task Force as:

- ❖ a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or
- ❖ a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies;



भारतीय प्रतिभूति और विनिमय बोर्ड Securities and Exchange Board of India

20. Disclosure Requirement

Index providers are required to inform SEBI immediately upon signing agreement with foreign jurisdiction for licensing indices. The index providers are required to necessarily intimate SEBI before any product is launched in the foreign jurisdiction based on such indices in foreign market.

21. Public Comments

In order to take into consideration views of various stakeholders, public comments are solicited keeping in mind the following issues;

1. Whether above code of conduct for index providers mitigate the concerns of misuse of information associated with rebalancing/reconstitution of indices?
2. Whether above code of conduct for index providers provide for greater level of disclosure and transparency regarding stocks moving on and out of indices?
3. Whether above code of conduct are sufficient to provide broad framework for Index Providers while managing/maintaining Indices including provisions for licensing indices in foreign jurisdictions?

Comments/ suggestions may be provided in the format given below:-

Name of entity / person / intermediary/ Organization			
Sr. No.	Issues	Suggestions	Rationale

Comments may please be emailed on or before June 20, 2017 to vishalp@sebi.gov.in or sent by post, to:-

Vishal M Padole
Assistant General Manager
Division of Policy, Market Regulation Department
Securities and Exchange Board of India
SEBI Bhavan, Plot No. C4-A, "G" Block ,
Bandra Kurla Complex, Bandra (East),
Mumbai - 400 051
