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European Securities and Markets Authority
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London, June 15, 2015

Dear Sirs,

We welcome the publication of the Consultation Paper *Draft guidelines on complex debt instruments and structured deposits* (the "***Consultation Paper***" or the "***CP***") by ESMA and we appreciate the opportunity to provide you with our comments.

Markit[1] is a leading global diversified provider of financial information services. We provide products and services that enhance transparency, reduce risk and improve operational efficiency of financial market activities. Our customers include banks, hedge funds, asset managers, central banks, regulators, auditors, fund administrators and insurance companies. By setting common standards and facilitating market participants' compliance with various regulatory requirements, many of Markit's services help level the playing field between small and large firms and herewith foster a competitive marketplace.[2] 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 also 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.

Introduction

Markit is an index provider for various index families across regions and asset classes, including for bonds, credit default swaps ("***CDS***") and loans. We administer and publish the composition of all

[1] Please see www.markit.com for further details.
[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.

Markit indices and we also calculate the levels of the Markit iBoxx suite of bond indices[3] as well as third-party indices. We have therefore actively followed and contributed to the discussions about the regulation of indices that are used as benchmarks that started in the wake of the Libor scandal. In July 2014, we issued a letter outlining the status of our compliance with the IOSCO Principles for Financial Benchmarks[4] followed by another letter in December 2014 confirming full implementation of the compliance framework.[5]

Comments

We welcome the publication of ESMA's Consultation Paper proposing guidelines on how to determine whether certain debt products and structured deposits respectively should be classified as "complex". However, we believe that ESMA could improve these guidelines by considering the following issues: (a) the classification of a product as "complex" should reflect not only the nature of the underlying but also the structural features of the product itself; (b) rather than classifying all products that reference "synthetic indices" as complex the classification should depend on the degree of transparency of methodology and composition of the individual index; and (c) ESMA should consider classifying "in-house or other non-public benchmarks" as non-complex as long as they comply with international standards on benchmarks,[6] are sufficiently transparent and appropriately address inherent conflicts of interest.

Question 3: Do you agree with the examples of debt instruments that incorporate a structure making it difficult for the client to understand the risk? If not, which examples and why not?

We are supportive of the objective[7] to strengthen investor protection by classifying certain debt instruments as "complex".[8] We also believe that ESMA has done a commendable job drafting guidelines outlining how financial products should be classified as "complex" in accordance with Article 25(10) of MiFID II. However, we recommend ESMA consider some further aspects in order to more accurately reflect the degree of "complexity" that investors are exposed to when investing in financial instruments.

Firstly, ESMA should consider that the complexity of a financial product is not only impacted by the nature of the underlying but it will often more directly depend on the specific features of the product itself.[9] For example, a product can reference a simple, public equity index but have optional features

[3] Markit provides indices and related services in equities, fixed income and economics. Markit is the administrator and calculation agent for the family of iBoxx indices which cover high-grade and high-yield bond markets in major currencies across regions. For details please see: https://www.markit.com/Product/IBoxx
[4] See https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf
[5] For Markit's statement of compliance with IOSCO Principles and related documents see: http://www.markit.com/Documentation/Product/Indices/Regulation
[6] The IOSCO Principles for financial benchmarks address issues in relation to transparency (Principle 9. Transparency of Benchmark Determinations) and conflicts of interest (Principle 3. Conflicts of Interest for Administrators). See https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf
[7] See paragraph 21 (vi)
[8] See paragraph 17, page 11.
[9] In this context, ESMA should also consider that such specific product features are often added because of specific investor interest or request.

including knock-ins/knock-outs[10] that make it difficult to understand for the average retail investor and hence "complex".

Secondly, we believe that a determination whether the nature of the underlying index makes the product complex, insofar as it makes it difficult for the investor to understand the structure, must be closely related to whether sufficient transparency is provided in relation to the index and whether inherent conflicts of its production are appropriately managed. We agree with ESMA's view that an "unfamiliar" nature of the underlying could make a product complex. However, we believe that sufficient transparency about the underlying index, namely about the index methodology and composition, will allow investors to understand the risk-return profile of the product. Further, availability of historical data will facilitate investors' ability to model liquidity and market risks. We therefore believe that ESMA should not classify products as complex solely based on the nature of the underlying index. Instead, the classification should also depend on whether sufficient transparency is provided to the investor about the methodology and composition of the index.

Specifically, we believe it would not be appropriate to classify all debt products that reference "synthetic indices" as complex.[11] This is because some of these indices will be widely used, standardized, transparent, and are established benchmarks for the asset class. Examples include CDS indices such as iTraxx and CDX[12] that are simple baskets of CDS single names without leverage. Further, many of such synthetic indices will comply with transparency and governance requirements that were established by the "IOSCO Principles for Financial Benchmarks" and are likely to be covered by European regulation of benchmarks[13] in the future. We therefore believe that the classification of a "synthetic index" should depend on whether investors are provided with sufficient transparency around their methodology and composition to ensure that risks can be properly understood.

Question 5: Do you agree with the definition of a structure making it difficult for the client to understand the risk of return of structured deposits and with the relevant examples proposed? If not, why not?

ESMA noted that "a key consideration" for its complexity assessment is whether average retail clients have sufficient expertise to understand how a return will be paid on a structured deposit and its calculation methodology.[14] While we generally agree with this view we also believe that, depending on the degree of complexity of the underlying index, the provision of sufficient transparency about calculation methods and composition of the underlying index can educate average retail investors about the payoff characteristics of the product.

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[10] A knock-in/knock-out option sets a floor/cap at a level beyond which the option becomes worthless for the holder. See: http://www.sdgm.com/Support/Glossary.aspx?term=Knock+in+and+knock+out+option

[11] See section 1.3 (21)(vi) under "Debt instruments with an unfamiliar or unusual underlying"

[12] iTraxx and CDX are tradable CDS indices administered by Markit: http://www.markit.com/product/indices

[13] EU Benchmark Regulation was proposed by the European Commission in September 2013 and is expected to be finalized before the end of 2015. Transparency and governance requirements for benchmarks are part of all three versions of the text and are likely to be part of final rules.

[14] Section 1.4, para 27 of CP.

Specifically, ESMA proposed to classify products referencing “”in-house” or “non-public” benchmarks as complex.[15] We agree that such approach would often be the right starting point as these types of benchmarks are often characterized by the lack of transparency about their methodology and composition, whilst their administrators are also exposed to significant conflicts of interest when calculating these indices. However, consistent with the approach outlined above we recommend ESMA allow for such indices to be classified as non-complex under certain conditions. Specifically, we believe investors are less likely to be exposed to unexpected risks as long as (a) sufficient information about methodology and composition of the index is provided and (b) the index administrator appropriately manages the conflicts of interest inherent in the administration of the index consistent with the IOSCO Principles.[16] In particular, sufficient independence must be embedded in the administration process of such indices.

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We hope that our above comments are helpful to ESMA. 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,

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[15] Section 1.4, para 30 (iii) of CP.
[16] Principle 3 “Conflicts of Interest for Administrators”: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf