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Consultation paper on Compliance Standards for Index Providers

1. To create an overarching framework of Principles for Benchmarks used in financial markets, the International Organization of Securities Commissions (IOSCO) published in July 2013 a framework of standards for financial benchmarks (or indices) based on international best practices. IOSCO adherents are expected to either comply with the IOSCO principles or explain any non-compliance. In addition, several foreign jurisdictions have articulated their own framework tailored to the requirements in their respective jurisdiction.
2. To prescribe a set of compliance standards for index providers in order to ensure quality and integrity of the indices administered, maintained or calculated by the index providers, a consultation paper has been issued by SEBI inviting public comments.
3. **Index Methodology:** Considering that the broad market indices are constructed to represent the performances of large universe of companies traded on an exchange, the paper provides a high level summary of the process and stock selection criteria adopted by index providers in India and internationally. Additionally, in respect of some of the indices (Nifty 50, S&P BSE SENSEX 30, FTSE 100, S&P 500, Nasdaq 100), the paper also delves in to Index methodology, in terms of calculation of the index, stock selection criteria, frequency of review of index, etc.
4. **Benchmark Indices – a representative of market:** The paper states the attributes of Benchmark Indices in India vis-à-vis all listed stocks and notes that both (Nifty 50 and Sensex 30) indices represent largest & most liquid companies and represents majority of average free float market capitalization, average total market capitalization and average daily turnover of all stocks traded. Accordingly, it has been brought out that Benchmark indices are broadly in line with that of universe of all stocks listed on exchanges in India.
5. **Trends in Sector exposure of Benchmark Indices vis-à-vis all listed stocks:** On this aspect, the paper notes that at a broad level, selection of stocks is primarily based upon market capitalization and liquidity. Across different geographies, prominence of one or two sectors is generally observed. Any change in the weightage of a sector amongst the listed space gets reflected in the corresponding benchmark index also. Accordingly, over a period of time, sectoral representation of stocks in the indices tend to undergo a change in line with overall share of various sectors in the listed universe.

6. Norms for benchmarks/benchmark administrators

The paper also notes the varied practices internationally in respect of benchmarks / benchmark administrators from the regulatory perspective. It is observed that in most jurisdictions, the framework is similar to the IOSCO principles, however, in some jurisdictions, the requirements for benchmarks / benchmark administrators are binding in nature while in others, the requirements are limited to those benchmarks designated as significant.

7. Based on IOSCO principles, practices observed internationally and suitability for domestic markets, the paper provides a suggestive framework for Index Providers in India, under three heads:

7.1. In respect of Indices based on which any product including derivatives, Exchange Traded Funds (ETFs), Market Linked Debentures (MLDs) are available/ traded on Indian stock exchanges.

7.2. In respect of Indices which are constructed based on data provided by Indian stock exchange(s).

7.3. In respect of Indices provided by the index providers that are used by Mutual Funds for benchmarking of funds performances or issuance of Index Funds.

8. For each of the abovementioned heads, the suggested framework casts responsibility on Indian Stock Exchanges and Asset Management Companies, as applicable, to ensure that the Index provider is in compliance with IOSCO Principles on a continuous basis. In respect of 7.1 and 7.2 above, in addition to ensuring compliance by the Index provider with the IOSCO principles, the stock exchange is also required to assess impact of any product based on such indices on trading in Indian market.

9. In order to take into consideration views of various stakeholders, the consultation paper has sought public comments on the above proposal with the following queries:

- Whether the above Compliance Standards for Index Providers would provide for greater level of disclosure and transparency, promote the reliability of benchmark determinations, and address benchmark governance and accountability mechanisms?
- Whether above Compliance Standards for Index Providers are sufficient to provide broad framework for Index Providers while managing/maintaining Indices including provisions for licensing indices in foreign jurisdictions?
- Whether there is need for a formal regulatory framework for Index Providers?
- Whether SEBI should specify certain indices as significant and apply the regulatory framework to only those indices as is done in some international jurisdictions as mentioned above?

A copy of the consultation paper is placed on the SEBI website www.sebi.gov.in under the link **Reports & Statistics>Reports>Reports for public comments**. Comments have been sought by **January 07, 2021**.

Mumbai
December 11, 2020