

# **INDEX GOVERNANCE FRAMEWORK**

**Terms of Reference**

**March 26, 2021**

**Nomura Securities Co., Ltd.  
Global Research Division,  
Financial Engineering & Technology Research Center  
Index Operations Dept.**

## **Index Operations Dept. (IOD)**

The Index Operations Dept. (IOD) was established to administer Nomura Securities Co., Ltd. (NSC)'s indices based on the Principles for Financial Benchmarks published by IOSCO (IOSCO Principles). Specifically, the IOD:

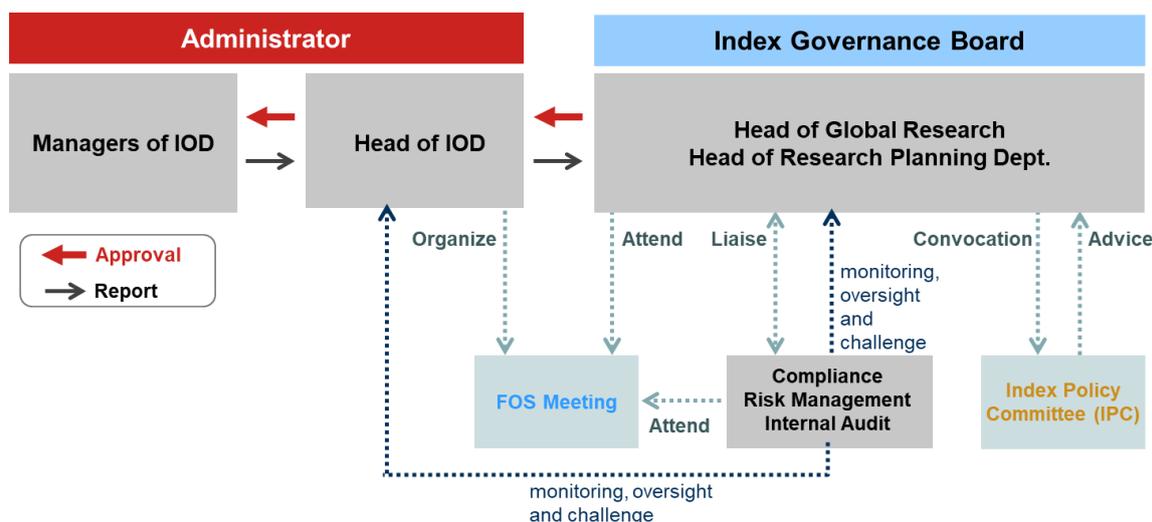
- is responsible for all aspects of index development, determination, dissemination, operation, and governance;
- determines the design of indices, including what data are to be used in the index calculation;
- makes changes to the constituents and their weightings in accordance with the calculation methodology relating to ongoing maintenance and periodic reconstitutions, and publishes information and maintains records of index weightings of all constituents;
- conducts reviews at least annually with regard to index methodologies and other matters in order to assess whether a material change to the index methodology is required due to a structural change in the markets; whether the values measured by NSC's indices have diminished or are not functioning due to a structural change in the market; or whether data in the index calculation are sufficient, appropriate and verifiable;
- changes index methodologies, if necessary, through a consultation process;
- disseminates the indices (including handling of enquiries and complaints, data distribution, contracting, and marketing);
- exercises oversight of third parties responsible for collection of relevant elements in the calculation and provision of the index;
- identifies, records, manages, mitigates, prevents, or remedies current and potential conflicts of interest and potential market abuse risks, and annually reviews the conflicts of interest register;
- responds to errors or disaster and recalculates or amends the index values as appropriate;
- implements index cessation;
- establishes the policies and control framework for ensuring the integrity of the benchmark and annually reviews them and their effectiveness; and
- keeps all activity trails all activity trails for five years that provide evidence that NSC is in compliance with national legal or regulatory requirements and submits all relevant documents if requested by the regulatory authorities.

## Index Governance Structure

NSC's indices are designed in an objective manner based on clearly prescribed rules and methodologies that are not allowed to be changed until passing predetermined procedures so as to mitigate any arbitrariness and/or discretion in the index determination process. NSC compliance with methodologies, rules, manuals, policies, and approval procedures in the index determination process is seen as vital, and the Index Governance Board (IGB) oversees and monitors the index administration.

NSC has established an oversight and governance structure concerning the indices managed by the IOD with the aim of protecting the integrity of the index determination process and addressing conflicts of interest. Details of the governance structure are as shown in Figure 1. The divisions responsible for Compliance, Risk Management, and Internal Audit monitor, oversee, and challenge both the IOD and the IGB.

**Fig. 1: Governance framework for NSC's indices**



## Index Governance Board (IGB)

The IOD comes under the oversight of the Index Governance Board (IGB), an entity which oversees and monitors index-related activities (such as index design, day-to-day operations including activities related to index determination undertaken by third parties, index calculation, provision of NSC's indices, methodology changes, index cessation and procedures for cessation, control framework, and handling complaints) and considers remedial actions to be taken where necessary, liaising closely with divisions responsible for Compliance, Risk Management, and Internal Audit. The IGB plays a key role in the approval process by reviewing any proposals made by the IOD from the point of view of the consideration of the features and expected usage of NSC's indices and the mitigation of risks associated with conflicts of interest,

operational issues, and compliance issues by confirming that the IOD has not violated any part of due process prescribed by the ongoing control framework. In addition, the IGB is responsible for conducting periodic reviews with regard to index methodologies and the control framework in NSC's index administration and its effectiveness, authorizing the IOD to undertake consultations with index users, and overseeing the results of internal and external audits and following up on the implementation of remedial actions.

The IGB annually reviews the index methodologies and data sufficiency in the index determination, convening and consulting with the Index Policy Committee (IPC) comprised of external experts to obtain professional advice on market changes, index methodologies, and other matters in terms of the appropriateness, integrity, transparency, reasonableness, and potential limitations of NSC's index determination.

To help the IGB oversee index administration in terms of the day-to-day operations of NSC's indices, the IGB reviews a monthly report from the IOD, which outlines the major activities undertaken during the month, and participates in Front Office Supervision (FOS) monthly meetings as mentioned below.

The IGB is currently made up of two members: the Head of Global Research (Chairperson) and the Head of the Research Planning Dept., Global Research, who are independent from the IOD's day-to-day operations. The IGB members are typically nominated, removed, and replaced in line with regular personnel changes at NSC.

### **Index Policy Committee (IPC)**

The Index Policy Committee (IPC) acts as an advisory body for the IGB, providing recommendations with regard to the appropriateness, integrity, transparency, reasonableness, and potential limitations of NSC's index administration.

The IOD stipulates the following in its internal rules: a) the IGB shall appoint the IPC members; b) members should be external experts and practitioners who are involved in the financial index business or asset management industry; c) members should not have any material conflicts of interest; and d) NDAs shall be signed between NSC and each IPC member; and e) membership shall be reviewed on an annual basis.

IPC meetings are held on an annual basis, although the IGB can convene an IPC meeting at any time if it is deemed necessary.

NSC does not disclose the names of IPC members or its candidates in order to maintain the independence of the IPC and prevent lobbying by market participants, unless regulatory authorities or auditors require such disclosure.

## **Front Office Supervision (FOS) meetings**

The IOD holds monthly FOS meetings, which bring together the IGB members and representatives from Compliance, Risk Management, and Internal Audit divisions, who are responsible for monitoring, overseeing, and challenging the effectiveness of the first line of controls. FOS meetings are used as a conduit to discuss issues and risks associated with index administration and to examine and evaluate the appropriateness of the IOD's activities.

FOS meetings are aimed at:

- reviewing the monthly report from the IOD, which outlines the major activities undertaken during the month and the “key risk indicators”, including the following:
  - ✓ Results of risk assessments related to employees' conduct and the IOD's activities
  - ✓ Incidents related to index calculations and administration activities in terms of conflicts of interest, operational issues, and compliance issues
- ensuring the IOD's adherence to supervisory procedures in its index administration, while maintaining consistency of approach where appropriate;
- cementing the supervisory framework through regular updates;
- ensuring that associated policies and the IOD's procedures are continually reviewed and updated where necessary; and
- assessing, overseeing, and challenging the effectiveness of the first line of controls.
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## **Key Control Framework**

NSC sets forth the following policies to establish and manage NSC's index determination, calculation, and publication procedures. The IOD reviews and updates the control framework at least annually. The IOD consults with the Compliance and Risk Management divisions as appropriate regarding its effectiveness. In addition, the results of periodic reviews are approved by the IGB.

<http://qr.nomuraholdings.com/en/guides/index.html>

- Index Governance Framework (Terms of Reference)
- Conflicts of Interest Policy
- Index Calculation Policy
- Complaints Handling Policy

## **Oversight of Third Parties**

NSC outsources activities relating to the collection of relevant elements in index calculation and the provision of NSC's indices, and discloses the identity and roles of third parties in index rule books or the "Index Calculation Policy". NSC is responsible for the appropriate oversight of the third parties. NSC sets forth the following policies and procedures to oversee third parties undertaking these activities. Specifically, NSC:

- defines the roles and obligations, operational policies, and contingency plans in a written agreement, a service level agreement, or a service level provision.
- oversees third parties' service quality by establishing a framework to perform a daily verification check over the index calculation prior to the publication of indices, or evaluating Information Technology General Control and Information Technology Application Control implemented by the third party annually, along with holding periodic meetings or receiving reports on the outsourced activities periodically from third parties.

## **Ensuring Data Sufficiency**

NSC stipulates in its internal rules that the IOD must regularly evaluate data to ensure they are sufficient to represent the interest measured by NSC's indices reliably and accurately. Evaluation standards set by IOD include the following.

- Sufficient coverage in terms of prices.
- A reasonable deviation range between prices obtained from a different source than the original source and prices used to calculate indices.

## Revision history

<b>Revision date</b>	<b>Details</b>
March 27, 2019	First edition
September 30, 2019	Partial revision of “Index Governance Board (IGB)”
March 26, 2021	Revisions to overall text