Guy Debelle: The Global Code of Conduct for the Foreign Exchange Market

Opening remarks by Mr Guy Debelle, Deputy Governor of the Reserve Bank of Australia, at the CLS FX Industry Reception, Sydney, 30 January 2017.

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Today I am going to talk about the Global Code of Conduct for the Foreign Exchange Market, which has been consuming a large part of my and David Puth's sleeping hours for more than 18 months. As I hope most of you know, Phase 1 of the Code was launched in May last year in New York.[1] The complete Code will be released in London in a few months' time at the end of May. It is pretty easy to find. It is available via the Bank for International Settlements (BIS) website or on the Australian Foreign Exchange Committee (AFXC) website.

Today I will reiterate the motivation for the work we are doing on the Code, why you all should be interested in it, and then update you on where we are at with the process and outline the way forward.

Why is the work going on? As I have stated before, the foreign exchange (FX) industry has been suffering from a lack of trust in its functioning. This lack of trust is evident both between participants in the market and, at least as importantly, between the public and the market. The market needs to move toward a more favourable and desirable location, and allow participants to have much greater confidence that the market is functioning appropriately.

A well-functioning foreign exchange market is very much in the interest of all market participants. This clearly includes central banks, both in their own role as market participants but also as the exchange rate is an important channel of monetary policy transmission. In a globalised world, the foreign exchange market is one of the most vital parts of the financial plumbing.

The Code sets out global principles of good practice in the foreign exchange market to provide a common set of guidance to the market, including in areas where there is a degree of uncertainty about what sort of practices are acceptable, and what are not. This should help to restore confidence and promote the effective functioning of the wholesale FX market.

The work to develop the Code commenced in May 2015, when the BIS Governors commissioned a working group of the Markets Committee of the BIS (which I Chaired until earlier this month) to facilitate the establishment of a single global code of conduct for the wholesale FX market and to come up with mechanisms to promote greater adherence to the code.[2]

Our Working Group comprises representatives of the central banks of all the major FX centres. This work is also very much a public sector–private sector partnership. We are being ably and vigorously supported in this work by a group of market participants, chaired by David. David's group contains people from all around the world on the buy side, including corporates and asset managers, and the sell side, along with trading platforms, ECNs and non-bank participants, drawing from the various Foreign Exchange Committees (FXCs) and beyond. Hugh Killen from Westpac is the Australian member of this group, representing the AFXC. All parts of the market are being involved in the drafting of the code to make sure all perspectives are heard and appropriately reflected.

There are two important points worth highlighting: first, it's a single code for the whole industry and second, it's a global code.

On the first point, the Code is replacing the existing codes of conduct that have been present in the FX market, including the ACI model code used here in Australia. Importantly, the Code covers all of the wholesale FX industry. This is not a code of conduct for just the sell side. It is there for the sell side, the buy side, non-bank participants and the platforms; its breadth is both across the globe and across the whole structure of the industry.

Hence the Code is relevant for all of you here in this room. The way it is relevant will depend on your engagement with the market. The guidelines for appropriate conduct are relevant for the buy side as well as the sell side. On the buy side it will also help to give you guidance as to what you can reasonably expect from your counterparty as you transact your FX business. What this means in practice is that the steps different market participants take to align their activities with the principles of the Code will necessarily reflect the size, complexity, type and extent of their engagement with the FX market.

As I mentioned earlier, the first phase of the Code was released in May 2016. It covers areas such as ethics, information sharing, aspects of execution and confirmation and settlement. The second phase covers further aspects of execution including e-trading and platforms, prime brokerage, as well as governance, and risk management and compliance.

We have provided market participants with a number of opportunities to comment on the second phase draft. We will be sending out a fatal flaw version of the complete Code for comment next week. The distribution to market participants will be principally through the FXCs but also through other industry associations as well. Again, we are endeavouring to ensure all perspectives are appropriately reflected in the Code.

The aim is for the full Code to be published in May and we are on track to achieve that.

Adherence to the Code

Alongside drafting the Code, we have also been devoting considerable time and effort to thinking about how to ensure widespread adoption of the Code by market participants. Clearly, that has been an issue with the various existing codes that have been in place in a number of markets over many years. It is evident that they were ignored on occasion, wilfully or otherwise.

One of our central aims in drafting the Code is for it to be principles-based rather than rules-based. There are a number of reasons why this is so, but for me, an important reason is that the more prescriptive the Code is, the easier it is to get around. Rules are easier to arbitrage than principles. If it's not expressly prohibited or explicitly discouraged, then it must be okay seems to be the historical experience. Moreover, the more prescriptive and the more precise the code is, the less people will think about what they are doing. If it's principles-based and less prescriptive then, as I just said, market participants will have to think about whether their actions are consistent with the principles of the Code.

So, we are working with the industry to produce a principles-based code of conduct rather than a set of prescriptive regulatory standards. It will not impose legal or regulatory obligations on market participants, nor will it supplant existing regulatory standards or expectations. But we do expect the principles in the Code to be understood and adopted across the entire FX market.

Our approach to adherence has a number of dimensions. We laid out our overall approach to adherence to the Code in New York in May last year.[3]

One dimension is market-based adherence mechanisms. An important element of discipline should come from the market itself and we are working closely with market participants on this. The adherence to a voluntary code will only come about if firms judge it to be in their interest and take the practical steps to ensure the code is embedded in their practices.

Firms will need to take practical steps such as training their staff and putting in appropriate policies and procedures. We have provided a draft Statement of Commitment for firms to publicly demonstrate their adherence to the Code. One reason for a public demonstration is that firms are more likely to adhere to the Code if they believe that their peers are doing so too.

Without blaming them for what occurred, more scrutiny from counterparties about how their FX transactions were being executed may have helped to reduce the incidence and severity of the market abuses that occurred in the past. FX transactions were sometimes regarded as ancillary to the core business, notwithstanding their potential impact on returns.

Ultimately the success of the Code in promoting integrity and restoring confidence in the wholesale FX market lies in the hands of its participants. That is why the Global FXCs issued a joint statement of support at the launch of the Code in New York as well as stating their intention to make adherence to the Code a likely requirement of FXC membership.[4] That would ensure the Code is embedded at the core of the FX market, but it is also important that it extends beyond that, and that there is, at the very least, an awareness of it across all market participants.

A second dimension of adherence is that the BIS central banks have signalled their commitment by announcing that they themselves will follow the Code, and that they expect that their counterparties will do so too.[5] To that end, the RBA will no longer transact in the FX market with those that don't commit to adhere to the Code after its release in May.

A third dimension of adherence is that we are talking to regulators in our various jurisdictions as to how they might use the Code in monitoring market conduct. In Australia, ASIC is very supportive of the development of the Code and is considering how it might utilise the Code in its market surveillance. The Financial Conduct Authority (FCA) in the UK is considering how they might incorporate the Code in the Senior Managers Regime there.

Conclusion

We are on track to complete the Code so that it will be released in London in May. At the end of that process, for the Code to be effective and for it to achieve what we want it to achieve, it will need to be accepted and endorsed across the full spectrum of market participants.

That said, the process does not really end, because as the foreign exchange market continues to evolve, the Code will need to evolve with it.

The work to date has reflected a very constructive and cooperative effort between the central banks and market participants. I would particularly like to acknowledge the enormous time and energy that David has contributed. All of us recognise the need to restore the public's faith in the foreign exchange market and the value of the Global Code in assisting that process and also in helping improve market functioning and confidence in the market.

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1 See www.bis.org/mktc/fxwg/gc_may16.pdf.

2 See www.bis.org/press/p150511.htm.

3 See www.bis.org/mktc/fxwg/am_may16.pdf. See also C Salmon (2016), 'Rebuilding Trust through the "FX Global Code": Reasons for optimism', available at www.bankofengland.co.uk/publications/Documents/speeches/2016/speech924.pdf, Speech given at the ACI UK Square Mile Debate, London, 7 September; and S Potter (2016), 'The Role of Best Practices in Supporting Market Integrity and Effectiveness', available at www.newyorkfed.org/newsevents/speeches/2016/pot160907, Remarks at the 2016 Primary Dealers Meeting, Federal Reserve Bank of New York, New York City, 7 September.

4 See afxc.rba.gov.au/news/afxc-26052016.html.

5 See www.bis.org/press/p160526a.htm.