Guy Debelle: Regulatory overview: The FX Global Code - defining the next steps towards a standard industry Code of Conduct

Opening remarks by Mr Guy Debelle, Deputy Governor of the Reserve Bank of Australia, at the TradeTech FX Asia Conference (appearance via video link), Singapore, 22 March 2017.

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Today I am going to talk about the FX Global Code. The Code is on track to be released in two months' time at the end of May. This is a culmination of two years' effort, involving considerable input from a sizeable number of foreign exchange market participants, both public and private. Today I will reiterate the motivation for the work we have been 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.

As I hope most of you know, Phase 1 of the Code was launched in May last year in New York.[1] The Code is pretty easy to find. It is available via the Bank for International Settlements (BIS) website or on the website of a number of foreign exchange committees (FXCs), including both the Australian Foreign Exchange Committee (AFXC) website and the Singaporean FXC. The text of the complete Code will be available in the same places from 25 May, following its public release.

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.

To that end, one of the guiding principles underpinning our work is that the Code should promote a robust, fair, liquid, open and transparent market. A diverse set of buyers and sellers, supported by resilient infrastructure, should be able to confidently and effectively transact at competitive prices that reflect available market information and in a manner that conforms to acceptable standards of behaviour.

The work to develop the Code commenced two years ago, in May 2015, when the BIS Governors commissioned a working group of the Markets Committee of the BIS (which I chaired until early January this year) 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 group comprises representatives of the central banks of all the major FX centres. Cindy Mok from the Monetary Authority of Singapore (MAS) has made a major contribution to the process, and is very much the person you should speak to in the Singapore market about the Code. The central banks of China, Hong Kong, Japan and Korea, as well as my country, Australia, are the other Asian central banks on the group.

This work is also very much a public sector–private sector partnership. We have been ably and vigorously supported in this work by a group of market participants, chaired by David Puth, CEO of CLS. 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 and beyond. All parts of the market have been 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 supplanting the existing codes that have been present in the FX market, including the Blue Book that is used in Singapore, and the ACI model code that is used in Australia.

Importantly, the Code covers all of the wholesale FX industry. This is not a code 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 at this conference. 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 Code, in addition to receiving the direct input of the Market Participants Group led by David Puth. Over the past few months, drafts of the full text of the Code have been distributed to market participants for their review, principally through the various FXCs, but also through other industry associations to ensure all perspectives are appropriately reflected in the Code. Through this process, quite a few thousand comments were received.

In my view, the text of the Code provides the best and most appropriate guidance we could give, given the sometimes wide range of feedback received, particularly on those small number of issues which are most controversial in the market. The most obvious example of this is 'last look'. This issue has generated considerable passionate discussion. I would expect that discussion to continue after the release of the Code in May and that the Code might evolve as a function of that discussion. I would like to make the point that if market participants think it would be preferable for the Code to have gone further, they are welcome to go down that path in their operations. On the other hand, it would not be desirable for the converse to occur, namely for market participants' practices to fall short of the principles described in the Code. That said, I think it is good outcome of the process that we were able to distil the points of contention down to a small number of (not insignificant) issues. Outside of a small number of contentious areas, the feedback was reflective of a widely held consensus. Market participants have recognised the Code's aim of helping move the FX market to a better place.

I will illustrate that with a couple of the areas that were addressed in the first phase of the Code, which is already in the public domain. In the first phase, topics were covered that the market was looking for guidance on sooner rather than later and that were potentially having an adverse effect on market functioning.

One example of this is around information sharing, where many market participants have highlighted that they are unsure what information can be conveyed to counterparties and other market participants. While it is clear (or at least should be) that disclosing the details of a client's order book to a counterparty is not acceptable, market participants have noted that there is much less clarity around what level of aggregation, say, is necessary in order to convey market colour appropriately.

As a result, it appears some market participants are being very conservative in sharing information, which can have implications for the effective functioning of the market. This is notwithstanding the guidance provided in this area in the Global Preamble put out by the global Foreign Exchange Committee, in March 2015.[3] The Global Code takes the material in the Global Preamble and fleshes it out a bit more, including with some examples of what is, and isn't, appropriate communication, and why.

Similarly, there have been diverse opinions around what is appropriate behaviour in terms of order handling. There have been some very public instances of inappropriate behaviour around order handling that have come to light in recent years. The market is seeking greater guidance as to what principles should be followed, including the different standards that may apply depending on whether an intermediary is functioning as principal or agent.

This is one area that was not adequately covered in the pre-existing codes that the various FXCs had endorsed for the FX market. It is an area where we are aiming to provide the sought-after guidance. But we are not writing a procedures manual for order handling. Rather we are articulating principles that need to be taken into account. Individual firms may then take these principles and reflect them in their own procedures manual. Our aim in articulating these principles is to provide market participants with the framework in which to think about how they handle stop-loss orders. The emphasis here is very much on the word 'think'. The Global Code will not provide the answers to all your questions, but it should help you ask the right questions.

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, 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 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.[4] We will provide a more comprehensive description of the suite of mechanisms to support adherence to the Code alongside the release of the Code in May.

One critical 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.[5] 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.[6] 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, the securities regulator, 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.

Given that we are only providing the full text of the Code to the market in May, there will be a period of time for market participants to adjust their practices where necessary (which should hopefully not be much) to be in line with the principles in the Code. This period of time might potentially be as short as six months, but no more than twelve months for the vast majority of market participants. How much effort this might require will in part depend on the nature and extent of your engagement with the FX market. In drafting the Code, we have always kept the principle of proportionality at front of mind.

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. I ask you all as participants in the foreign exchange market to familiarise yourself with the principles of the Code and verify that your operations in the market align with them.

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 contributed by David Puth and the Market Participants Group as well as the team of my fellow central bankers. 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.

Let me finish with three things to take away with you:

- Read the FX Global Code when it is released on May 25th.
- Adapt your business where appropriate to conform with the principles of the Global Code.
- Ask your FX counterparties whether they are committed to the principles of the Global Code.

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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.rba.gov.au/afxc/about-us/pdf/global-preamble.pdf>.

[4] 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 at the ACI UK Square Mile Debate, London, 21 September; and S Potter (2016), 'The Role of Best Practices in Supporting Market Integrity and Effectiveness', Remarks at the 2016 Primary Dealers Meeting, Federal Reserve Bank of New York, New York City, 7 September, available at <www.newyorkfed.org/newsevents/speeches/2016/pot160907>.

[5] See <afxc.rba.gov.au/news/afxc-26052016.html>.

[6] See <www.bis.org/press/p160526a.htm>.