Foreign Exchange Working Group

REPORT ON ADHERENCE TO THE FX GLOBAL CODE

May 2017

Introduction

The FX Global Code (Code) was created with the intention that it would become an integral part of the wholesale foreign exchange market (FX Market) globally and promote a robust, fair, liquid, open and appropriately transparent FX Market. It was developed by the Foreign Exchange Working Group (FXWG), which was directed to be established by the BIS Governors under the auspices of the Markets Committee in May 2015, in close partnership with a Market Participants Group (MPG).[1]

The Code is voluntary in nature and to be effective it will need to be embraced, adopted and adhered to by market participants across the FX Market. Accordingly the FXWG has sought to develop an approach that will support the Code by promoting and incentivising widespread adoption and adherence to it. Market participants will need some time to review and adjust their practices to align with the principles of the Code and it is anticipated, based on feedback from a broad range of market participants, that most will need approximately 6-12 months to do so.

This paper sets out the FXWG's blueprint for achieving widespread adoption of the Code and references the important, supportive work that has been undertaken in parallel by the MPG.

[1] The MPG represents the diversity of market participants within the FX Market drawing on the expertise of senior individuals from the buy side, including corporates and asset managers, and the sell side, along with trading platforms, Electronic Communication Networks (ECNs) and non-bank participants.

Blueprint for Achieving Adoption

The FXWG's blueprint for achieving adoption is organised around four key tenets: (I) The Code should be clear, relevant and reflect good practice in the FX Market; (II) It is the responsibility of market participants to take appropriate steps to adopt the Code in their day-to-day practices and culture; (III) It is the role of central banks to lead by example and demonstrate their commitment to promoting and maintaining good market practice; and (IV) It is important that market participants and central banks maintain an active engagement with the Code and have appropriate structures in place to ensure that it remains relevant. These four tenets and the related mechanisms that have been designed to support adherence are detailed below.

TENET 1

The Code: *The Code should be clear, relevant and reflect good practice in the FX Market.*

The Code sets out what constitutes good practice and in certain areas helps to further develop the FX Market's understanding of good practice. It is universal in application, covering FX Market participants globally. The Code incorporates the principle of proportionality in order to strike a balance between respecting the diversity across jurisdictions, both in terms of market structure and the regulatory treatment of FX, and retaining consistency in what is a global initiative. In particular, the foreword of the Code explicitly acknowledges that "the steps that different Market Participants take to align their activities with the principles of the Global Code will necessarily reflect the size and complexity of the Market Participant's FX Market activities, and the nature of the Market Participant's engagement in the FX Market, and will take account of Applicable Law".

Within the Code text, many of the high-level principles require market participants to exercise judgement when implementing the Code. For example, the Code sets out principles for what market participants should consider when designing their risk management framework, but acknowledges that what constitutes an effective framework will vary substantially between market participants based on the nature of their activities. This principles-based non-prescriptive approach is in line with the voluntary nature of the Code and encourages market participants to ensure that they understand the principles of the Code and carefully consider whether their actions are consistent with them.

TENET 2

An effective framework: *It is the responsibility of market participants to take appropriate steps to adopt the Code in their day-to-day practices and culture.*

The FXWG has identified three key elements that it considers market participants will need to have regard to in order to establish an effective framework for adopting and adhering to the Code:

- How the Code is embedded in a market participant's practices;
- How a market participant will subsequently monitor its practices against the Code; and
- How a market participant might demonstrate its adherence to the Code.

EMBEDDING

It is important for market participants to embed the Code's guidance in their day-to-day operations and help create a strong culture, both within their organisation but also in the market as a whole, where good practices are promoted and fostered.

• In their own organisations, market participants will need to assess whether their practices are consistent with the guidance within the Code, for example, by undertaking a review of existing policies and procedures, and where necessary, taking appropriate and proportionate steps to align practices. Training and education of staff will be particularly important to effectively embed the principles of the Code.

• More broadly, market participants have an interest, and a role to play, in promoting and upholding good practices in the market as a whole. This can be partly achieved through leading by example, but can also be supported by having similar expectations of counterparties and other market participants and helping to raise awareness of the Code in interactions with such parties.

To facilitate this:

o The FXWG, with assistance from the MPG, has undertaken an extensive outreach exercise to more than 120 industry associations and key market infrastructure providers globally. Given the diversity of market participants to whom the Code is applicable, associations and infrastructure providers are key vehicles for raising awareness of the Code. The response from associations and infrastructure providers has been very positive; some have already published statements in support of the Code and have started educating and raising awareness among their membership / client base.

o A number of infrastructure providers and associations have indicated that it would be possible to include references to the Code in their rulebooks and educational material where appropriate. This could provide a strong signal regarding good practice and would embed the Code in existing organisational structures and literature.

MONITORING

It is equally important that market participants that have embedded the Code's guidance into their practices establish appropriate mechanisms to monitor how effectively they have done so.

• In their own organisations, market participants may look to the text of the Code itself for some practical guidance on implementation but ultimately market participants will need to exercise their own judgement of what is appropriate having regard to the principle of proportionality. It can be expected that the action of individual market participants will reflect the size and complexity of their FX activities, and the nature of their engagement in the FX Market.

• Beyond the level of the individual market participant, the FXWG believes it is important to monitor the FX Market's progress in embedding the Code in practices and culture.

To facilitate this:

o The FXWG has sought to develop a number of mechanisms such as the Statement of Commitment and the survey described below, that will facilitate effective monitoring by individual market participants, as well as providing a broader indication of the FX Market's progress.

DEMONSTRATING

The FXWG believes that market participants, by demonstrating their own adherence to the Code, can raise awareness about, and increase the profile of the Code, and can provide other market participants with an accessible means for comparing potential counterparties and service providers.

To facilitate this:

o The FXWG has developed a Statement of Commitment (Annex 3 to the Code) which market participants can use publicly, or bilaterally, to support key objectives of the Code such as enhancing transparency, efficiency and functioning in the FX Market.

- The Statement of Commitment (Statement) provides a single, common basis by which each market participant can represent that it: (i) supports the Code and recognises it as a set of principles of good practice for the FX Market; (ii) is committed to conducting its FX Market activities in a manner that is consistent with the principles of the Code; and (iii) considers that it has taken appropriate steps, based on the size and complexity of its activities, and the nature of its engagement in the FX Market, to align its activities with the principles of the Code. It will be up to each market participant to decide whether and how to use the Statement.
- The concept of proportionality is also embedded in the Statement. For some market participants, for example, appropriate steps may include reviewing existing policies and procedures, assessing the appropriate levels of senior management oversight and / or establishing dedicated staff training on the Code, or embedding the good practices within the Code into existing training.

o Recognising the importance of market participants demonstrating adherence to the Code, the MPG has been exploring the potential creation of public registers where market participants could publicly demonstrate their use of the Statement. The FXWG encourages market-based initiatives such as this that are intended to support the Code and its objectives. Work on public registers is still in development with a number of possible options under consideration, including establishing a link between registers for ease of overview by interested parties, such as prospective counterparties and clients.

TENET 3

The role of central banks: *To lead by example and demonstrate their commitment to promoting and maintaining good market practice.*

Central banks have played an important role in the creation of the Code. They have initiated the process, organised the work, contributed to the drafting of the Code and led the thinking on adherence. It is therefore appropriate that central banks lead by example and demonstrate their commitment to promoting and maintaining good market practice.

To facilitate this:

o Central banks intend to adhere to the principles of the Code except where this would inhibit the discharge of their legal duties or policy functions[2]. Like other market participants, central banks will require time to review their operations in regards to the published Code and will endeavour to do so in a similar timeframe. Further, central banks will demonstrate their commitment by using the Statement, or similar.

o Central banks will expect that their regular FX trading counterparties adhere to the principles of the Code, except where this would inhibit the discharge of their legal duties or policy functions[2].

o A number of Foreign Exchange Committees (FXCs) and/or their central bank sponsors have decided to publicly link membership of the FXC with adherence to the Code, in a manner consistent with Applicable Law. All FXC members (or their firms, where membership is on an individual basis) who fall within the scope of the Code will be expected to commit, using the Statement or similar, to their adherence in order to achieve and maintain FXC membership. Appropriate transitional arrangements will be in place and central banks are consulting with their FXCs on the precise requirements.

TENET 4

Maintaining the effectiveness of the Code: *It is important that market participants and central banks maintain an active engagement with the Code and have appropriate structures in place to ensure that it remains relevant.*

The Code has benefitted from a significant investment of time and effort by those market participants directly involved in its development via the MPG and regional FXCs, as well as central banks. This has been essential to the creation of a relevant Code, and to the establishment of a framework which promotes and facilitates widespread adherence. It is equally important this investment is maintained through time. Central banks in association with market participants have committed to keeping the Code up to date and ensuring it will evolve as the market evolves.

To facilitate this:

o Central bank Governors have agreed that the Code will be collectively owned and maintained by the FXCs, through the Global Foreign Exchange Committee (GFXC) framework, a global association of FXCs, which has been launched alongside the publication of the Code.

o The GFXC will actively promote the Code and members in turn will promote adherence to the Code in their own jurisdictions. It will also provide a forum for the exchange of views about good practice regarding effective mechanisms to support adherence.

o In terms of maintaining the Code, the GFXC will assess regularly whether there are new market developments that warrant incorporation into the Code. Where appropriate, the GFXC will consider updating the Code to address these areas, consulting with their local FXC memberships in the process. On a less frequent basis, the GFXC will oversee a more comprehensive review of the Code in line with the process that has been adopted in drafting the Code, namely opening the Code

[2] In light of the unique role of central banks as policy institutions, adherence to the Code will not limit a central bank's ability to meet its policy objectives. Where it is not possible for the discharge of a particular legal duty or policy function to be in strict accordance with all the principles of the Code, central banks will give precedence to the achievement of that policy purpose or legal duty.

to comments from market participants through their local FXCs and potentially through other avenues. The effectiveness of the adherence mechanisms can also be reviewed on a similar timetable.

o The GFXC will also monitor the success of the Code following its publication. Success will be measured in terms of progress on a number of dimensions such as the awareness of the Code by market participants, their commitment to the principles of the Code, their pace of implementation of the Code, and the impact of the Code on market practices and transparency in the FX market. The GFXC will use a broad survey of market participants to monitor success. It is expected that the survey takes place on an annual basis, with the first such survey being conducted shortly after the Code publication to act as a baseline for monitoring progress. The GFXC will review the results of the survey, which will inform the discussions and could serve as an input to the regular assessment of the necessary changes to the Code.

In addition, demonstrating their ongoing to commitment to the Code, the Governors of BIS member central banks have recommended that the Markets Committee (MC) assesses the effectiveness of the Code following its adoption. Such an assessment is expected to take place approximately three years after the launch of the Code in May 2017 and be conducted in consultation with the GFXC. The assessment would take into account issues such as: the breadth of adoption of the Code, the effectiveness of adherence mechanisms, the extent to which behaviour in the market has changed and the effect of the Code on market functioning.

Conclusion

The Code articulates good practice in the FX Market. Given the Code's voluntary nature it will only be effective in strengthening conduct standards if market participants from across the FX Market embrace, adopt and adhere to it. As set out above, the FXWG's blueprint for achieving widespread adoption of the Code is designed to facilitate market participants taking the steps necessary to effectively embed the Code, and to monitor and demonstrate their adherence to it. It also recognises the important role of central banks, to lead by example, and to work alongside market participants in maintaining the relevance of the Code through time.