

## **Hiroshi Nakaso: Developing a global code of conduct for the foreign exchange market**

Opening remarks by Mr Hiroshi Nakaso, Deputy Governor of the Bank of Japan, at the BIS FXWG-MPG meeting, Tokyo, 26 February 2016.

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### **I. Introduction**

It is a great pleasure to welcome the BIS FXWG (Foreign Exchange Working Group) and MPG (Market Participants Group) joint meeting on developing a single global code of conduct for the foreign exchange market.<sup>1</sup>

In March last year, the eight foreign exchange committees in the major financial centers gathered here in Tokyo and adopted the “Global Preamble”<sup>2</sup> sharing their commitment to developing and promoting clear, robust, and implementable best-practice guidance in the foreign exchange market. Building on the Global Preamble, in May last year, the BIS governors agreed to set up a working group to facilitate the establishment of a single global code of conduct for the foreign exchange market. Since its inception, 16 central banks and more than 30 private-sector professionals from around the world have been participating actively in this project. Without a doubt, this project is a cornerstone for the ongoing global initiatives to address the misconduct issues in the broad financial market. Thanks to the hard work of each member and the excellent leadership of the Chair, Guy Debelle, significant progress has been made with the first public update, which is envisaged in May 2016. As a member of the FXWG, the Bank of Japan is honored to host this joint meeting with the MPG today.

In my remarks, first I would like to share my views on why we need the global code and how it matters to the central banks, and then express my support on key concepts of the code that have been shared among our colleagues here.

### **II. Why we need the global code**

Let me begin with my thoughts on how the global code can contribute to the sound functioning of the foreign exchange market.

It has been broadly agreed that the single global code of conduct for the foreign exchange market aims to promote a robust, fair, liquid, open, and transparent market. Achieving this goal is crucial to the sound functioning and development of the foreign exchange market.

Why is a well-functioning foreign exchange market highly important from a central bank’s perspective? We closely monitor the financial market developments when conducting our policy in pursuit of price and financial stability. Financial markets carry crucial information regarding market participants’ views on economic and financial conditions, and also play a vital role for transmission of our policy. Financial markets must be functioning effectively to play such important roles.

A well-functioning market needs to be supported by sufficient market liquidity. Therefore, I strongly believe that the central banks should continue to be committed to enhancing market

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<sup>1</sup> “Foreign Exchange Working Group” (FXWG), which consists of 16 central banks, was established under the auspices of the BIS Markets Committee to facilitate the establishment of a single global code of conduct for the foreign exchange market and to promote greater adherence to the code. To support the FXWG, a “Market Participants Group” (MPG) was established, drawing on more than 30 private-sector professionals in the foreign exchange market. The relevant press release is available at <http://www.bis.org/press/p150724.htm>.

<sup>2</sup> Available at [http://www.fxcomtky.com/announce/pdf\\_file/global\\_preamble.pdf](http://www.fxcomtky.com/announce/pdf_file/global_preamble.pdf).

liquidity as part of our efforts to develop the code. According to the widely accepted definition of the BIS, “A liquid market is a market where participants can rapidly execute large-volume transactions with a small impact on prices.”<sup>3</sup> I believe that a robust, fair, open, and transparent market, where diverse types of participants with diverse business models can confidently transact will indeed support market liquidity, which in turn enhances the functioning of the foreign exchange market.

### **III. Key concepts of the global code**

Next, I would like to touch upon a few key concepts of the global code that have been shared among our colleagues here. I would like to express my strong support for these concepts, as they are crucial to improve market functioning.

#### **A. Principle-based code**

The first key concept is that the global code will become most effective when it is principle-based, taking into account the diversity of market participants.

The foreign exchange market is a large cross-border market uniquely featured with diverse participants. Indeed, we cannot find any other market where such a wide variety of financial and nonfinancial corporations transact on a daily basis. Over-the-counter (OTC) transactions prevail, and the electronic trading venues are also diverse, ranging from brokers to single- and multiple-dealer platforms. Regulatory settings covering foreign exchange transactions are also diverse in a range of jurisdictions.

A principle-based approach, rather than a prescriptive rule-based approach, is well suited to address such a diversity of participants and a complexity in market structures across the globe. Regarding the approach, Guy Debelle raised an important point in his speech last November, and let me repeat it here: History has shown that “the more prescriptive it becomes the easier it is to get around [because] rules are easier to arbitrage than principles.”<sup>4</sup> I fully support his views.

#### **B. Collaboration between the public sector and the private sector**

The second key concept of the global code is that continuous collaboration between the public sector and the private sector is indispensable.

The foreign exchange market has evolved through close collaboration between the public and private sectors. For example, the foreign exchange committees in the major financial centers typically comprise both central bankers and private-sector participants.

Work on the global code has also achieved progress through a public sector-private sector partnership. The MPG, which consists of both sell-side and buy-side institutions, has been providing valuable insight based on its members’ expertise in market practices and innovation.

It would be desirable that innovations led by the private sector continue to evolve under the appropriate code of conduct, thereby improving market functioning. The public sector should endeavor to align the private sector’s incentives appropriately to support further market innovation and sound functioning of the foreign exchange market.

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<sup>3</sup> Bank for International Settlements (1999), “Market Liquidity: Research Findings and Selected Policy Implications,” *CGFS Publications* No 11.

<sup>4</sup> See Guy Debelle, “The Global Code of Conduct for the Foreign Exchange Market,” speech at the FX Week Europe conference in London on November 25, 2015. Available at <http://www.rba.gov.au/speeches/2015/sp-ag-2015-11-25.html>.

### **C. User-friendliness**

The third key concept is that the global code should be succinct, clear, and easy to use. The code becomes valuable only when market participants make good use of and adhere to it in their day-to-day business at the practical level.

In addition, bearing in mind the existence of diverse participants and diverse business models, I would like to emphasize the importance of clearly addressing what market participants *can* do under the code. This is to prevent over-cautious behavior of market participants which could be detrimental to fostering well-functioning markets. As an initiative to enhance market functioning through clearer dialogue among market participants, the Tokyo Foreign Exchange Market Committee developed the “Tokyo Blue Book” in April last year.<sup>5</sup> The book provides guidance with succinct, clear statements and practical examples to help promote understanding of the code among Tokyo market participants.

### **IV. Concluding remarks**

I firmly believe that the successful development of a single global code and greater adherence to it will reinforce the functioning of the foreign exchange market and facilitate vibrant, sound development of the market. The Bank of Japan has been, and will continue to fully support and be committed to the work of the global code. I am confident that this Tokyo meeting will provide us with a valuable opportunity to achieve further progress in our work.

Thank you very much for your kind attention.

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<sup>5</sup> Available at [http://www.fxcomtky.com/coc/code\\_of\\_conduct\\_e2015.pdf](http://www.fxcomtky.com/coc/code_of_conduct_e2015.pdf).