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

Speech by Mr Guy Debelle, Assistant Governor (Financial Markets) of the Reserve Bank of Australia, at the TradeTech FX, London, 14 September 2016.

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Thank you for having me here today to talk about the Global Code of Conduct for the Foreign Exchange Market. As I hope most of you know, Phase 1 of the Code was launched in New York in late May.[1] The Code is pretty easy to find. It is available on the JSC website or via the Bank for International Settlements (BIS) website.

Today I will reiterate the motivation for the work we are doing on the Global Code, 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 on previous occasions, the foreign exchange (FX) industry is 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 Global 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 Global Code commenced in May last year, when the BIS Governors commissioned a working group of the Markets Committee of the BIS 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]

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 Global Code is replacing the existing codes of conduct that have been present in the FX market, including the NIPS code here in London. On the second point, 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. The Code is intended to apply to all aspects of the wholesale foreign exchange market.

I am chairing this work, with Simon Potter of the Federal Reserve Bank of New York leading the work on developing the code and Chris Salmon of the Bank of England leading the adherence work. Our Working Group comprises representatives of the central banks of all the major FX centres, drawing on the membership of the Markets Committee which is comprised of heads of the market operations areas of the 15 major currency areas.[3] Given our roles, we are all very much interested in the effective functioning of the FX market. Again, it is very much a global effort reflecting the global nature of the foreign exchange market.

This work is also very much a public sector–private sector partnership. In that regard, we are being ably and vigorously supported in this work by a group of market participants, chaired by David Puth, CEO of CLS. The 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. There are a number of members of David's group that are from the London market including non-banks, platforms, asset managers as well as banks. Hence all parts of the market are being involved in the drafting of the code to make sure all perspectives are heard and appropriately reflected.

At the outset we decided to split the topics we intend to cover in the Code into two parts. This first phase covers areas such as ethics, information sharing, aspects of execution and confirmation and settlement. The second phase is covering further aspects of execution including e-trading and platforms, prime brokerage, as well as governance, and risk management and compliance. We have made substantial progress in drafting the second phase. It will be circulated for comment through the various FXCs in early October. So, the JSC will be providing feedback on behalf of the London market.

As was the case with the first phase, there will be three opportunities for market participants to provide feedback on the material over the next six months or so. We will endeavour to make clear how the feedback provided has been addressed through each of the feedback phases.

The aim is for the full Code to be published in May 2017 and we are on track to achieve that.

I will now talk about a couple of the areas that are 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 Committees, in March 2015.[4] 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. There will be more examples on information sharing provided in the second phase of the Code.

Similarly, there have been diverse opinions around what is appropriate behaviour in terms of order handling. While there have been some very public instances of inappropriate behaviour around order handling that have come to light in recent years, in other areas, 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.[5]

This is one area that was not adequately covered in the pre-existing codes of conduct 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.

In a similar vein, I will repeat a point that I have made a number of times in the past. One of our most 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.

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 Global 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.

As I said earlier, 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.

We laid out our overall approach to adherence to the Code in New York in May.[6] Chris Salmon will speak further on adherence in the coming weeks. Simon Potter spoke recently in New York about the philosophy underpinning our work.[7]

We intend to work closely with market participants in the period ahead to facilitate the development of market-based mechanisms which demonstrably embed the Global Code within firms' culture and practices. These mechanisms need to be sensitive to existing law and regulation and to the diverse nature of FX markets globally. Hence a 'one size fits all' approach to adherence would not be appropriate. We need to strike the right balance between respecting the existing diversity across different markets, and establishing globally consistent and effective adherence mechanisms.

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 will probably recommend widespread use of attestations by firms about their adherence to demonstrate how widely the Code is followed. Firms are more likely to adhere to the Code if they believe that their peers are doing so too.

The success of the Global 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, making clear their intention for the Global Code to become an integral part of the wholesale FX market.[8]

Furthermore the BIS central banks signalled their commitment by announcing that they themselves will follow the Code, and that they expect that their counterparties will do so too.[9] We are also talking to regulators in our various countries as to how they might use the Code in monitoring market conduct.

We are on track to complete the Code so that it will be released following the Global Foreign Exchange Committee meeting here in London in May 2017. 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 by the FXCs and market participants more generally.

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.

Conclusion

That, I trust, gives you a reasonable overview of the state of play on the Global Code.

A lot of work has been done to get us to this point. There is still work to be done to complete the task.

The work to date has reflected a very constructive and cooperative effort between the central banks and market participants. 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 how the market functions. I expect that cooperative relationship will continue as we see this process through to its conclusion in May next year.

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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/about/factmktc/fxwg.htm>.

4 See <www.rba.gov.au/afxc/about-us/pdf/global-preamble.pdf>.

5 I am not using these terms in the legal sense that is sometimes the case in particular jurisdictions, but rather in terms of common market parlance.

6 See <www.bis.org/mktc/fxwg/am_may16.pdf>.

7 S Potter, '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 2016.

8 <afxc.rba.gov.au/news/afxc-26052016.html>

9 <www.bis.org/press/p160526a.htm>