Guy Debelle: The Global FX Code of Conduct

Address by Mr Guy Debelle, Deputy Governor of the Reserve Bank of Australia, to the Thomson Reuters Industry Event "Examining the FX Code of Conduct", Sydney, 15 June 2017.

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The FX Global Code of Conduct was launched just over two weeks ago in London. It is available on the Global Foreign Exchange Committee's website, www.globalfxc.org.[1] Today I will reiterate the motivation for the work, highlight the main features of the Code and adherence, summarise how we developed the Code and outline the way forward.

Firstly, why has this work been necessary? The foreign exchange (FX) industry has been suffering from a lack of trust. 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.

The Code sets out global principles of good practice in the FX market to provide a common set of guidance to the market. This will help to restore confidence and promote the effective functioning of the wholesale FX market.

A well-functioning FX 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.

One of the guiding principles that has underpinned our work in developing the Code 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. Note that I am talking about all sections of the FX market: buyers, sellers and infrastructure.

The work to develop the Code began 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 do two things: first, establish a single global code of conduct for the wholesale FX market and second, to come up with mechanisms to promote greater adherence to the Code.[2]

This work was very much a public sector–private sector partnership. We were ably and vigorously supported by a group of market participants, chaired by David Puth, CEO of CLS. David's group contained 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. All parts of the market were involved in the drafting of the Code to make sure all perspectives were 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 supplants the existing codes that have been present in the FX market. So there is now one single code. 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; it reaches around the globe and across the whole industry. The way it is relevant will depend on the nature of the engagement with the FX market. What this means in practice is that the steps different market participants take to align their activities with the principles of the Code will differ, reflecting the size, complexity, type and extent of their engagement with the FX market.

On the second point, it's a global code: our group contained representatives from the central bank and private sector from all the 16 largest FX centres, including both developed and emerging markets.

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

The complete Code comprises 55 principles spanning these issues. The principles are written in plain language and should be easily read and understood by market participants. The principles are supplemented by a suite of examples to illustrate their practical application.

Market participants had a number of opportunities to comment on the Code, in addition to the direct input of the Market Participants Group. Before its release, drafts of the full text of the Code were distributed to market participants for their review, principally through the various FXCs, but also through other industry associations to ensure all perspectives were appropriately reflected in the Code. Through this process, over 10,000 comments were received.

The Code reflects our collective judgement as to what constitutes good practice in the market, taking account of the feedback received. I think it is a good outcome of the process that we were able to distil the points of contention down to a small number of issues. Outside of these, the feedback reflected a widely held consensus as to what is good practice. The degree of consensus and the willingness to contribute to the process reflect the fact that market participants have recognised the Code's aim of helping move the FX market to a better place.

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. 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 market participants will have to think about whether their actions are consistent with the principles of the Code.

But we have not written a procedures manual. Rather, we have articulated principles that need to be taken into account. Individual firms may then take these principles and reflect them in their own procedures manuals. Our aim in setting out these principles is to provide market participants with the framework in which to think about how they, for example, handle stop-loss orders. The emphasis here is very much on the word 'think'.

Adherence

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

We have worked with the industry to produce a principles-based code rather than a set of prescriptive regulatory standards. The Code is not regulation. It will not impose legal or regulatory obligations on market participants, nor will it supplant existing regulatory standards or expectations.

We have developed a blueprint for adherence that has been published alongside the Code and sets out the key elements we think will be required for the Code to be successful – and the steps that have been taken, and will be taken, to ensure this is the case.[3]

One critical dimension is market-based adherence mechanisms. An important element of discipline should come from the market itself. 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. Such practical steps would include 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.[4] 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. That is, an important source of pressure to adhere should come from other market participants. To provide visibility around this, there are a number of market-based initiatives to provide public registries where market participants can demonstrate their use of the Statement of Commitment. These registries will be in the public domain in the near future.

More broadly, market participants have a vital interest, and a role to play, in promoting and upholding good practices in the market as a whole.[5] 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 their market interactions. In that regard, we have reached out to more than 120 industry associations and key market infrastructure providers globally. In Australia, that includes AFMA and the Finance and Treasury Association, as well as the NZFMA.

Ultimately the success of the Code in promoting integrity and restoring confidence in the wholesale FX market lies in the hands of its participants.

Another aspect of market-based adherence comes through the FXCs. In due course, adherence to the Code is likely to become a requirement of FXC membership. In Australia's case, adherence to the Code will be a requirement of membership of the Australian foreign exchange committee by the end of this year. That would ensure the Code is embedded at the core of the FX market, given the extent of coverage of the FXCs. 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] In the case of the RBA, we will require that our counterparties sign the Statement of Commitment, just as we will ourselves.

Given that we provided the full text of the Code to the market only last month, there will be a period of time for market participants to adjust their practices where necessary to be in line with the principles in the Code. I would not expect much time should be required to do this. 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 engagement with the FX market. In drafting the Code, we have always kept the principle of proportionality at front of mind.

Finally, it is vital that the Code remains up to date and evolves as the market evolves. The Code will be collectively owned, maintained and updated by the Global Foreign Exchange Committee (GFXC), which met for the first time in London in May. This will continue the public sector – private sector partnership which has supported the development of the Code.

The GFXC will regularly assess whether new information or market developments warrant updates or additions being made to the Code. As the first example of this, given diversity of views on the use of last look in the market, the GFXC is currently requesting feedback on trading in the last look window.[7] On a less frequent basis, the GFXC will oversee a more comprehensive review of the Code.

Conclusion

The Global Code is the culmination of two years of work by a group of people from both the private and public sectors. The work reflected a very constructive and cooperative effort between the central banks and market participants. We all undertook this work in addition to our regular responsibilities, at all hours of the day and night. This contribution of time and effort reflected the fact that all of us recognise the need to restore the public's faith in the foreign exchange market. We share the view that the Global Code plays an important role in assisting that process and also in helping improve market functioning and confidence in the market.

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1 An app version has also been made available by an external party: app.policystore.ch/C/FXCode/.

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

3 www.globalfxc.org/adopting_the_global_code.htm

4 The Statement of Commitment is in Annex 3 of the Code.

5 The Banking and Finance Oath has a very similar motivation www.thebfo.org/home.

6 See www.bis.org/press/p170525.htm.

7 See www.globalfxc.org/consultative_process.htm