BANK OF ENGLAND

Speech

Securing success for the FX Global Code

Speech given by
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Good morning, I am delighted to be here at TradeTech FX Europe.

Central banks have a deep and enduring interest in the effective functioning of markets. We sit at the heart of our financial systems, supporting their smooth running through our operations, and in turn relying on them ourselves in fulfilling our mandates. Our desire to promote effective financial markets manifests itself in many ways but we often act in a convening role – working together with the private sector to achieve the right outcome for the system as a whole. This has been enduring feature of the Bank of England's activities, stretching back to some of our earliest efforts in the 1800s to marshal the resources of the City to rescue failing banks. Collective central bank action has long been a feature too; for example, CLS – which many you in the audience today rely on to eliminate foreign exchange settlement risk – was created at the encouragement of central bankers.[1]

More recently, central banks have come together to address the systemic risks created by conduct issues within large swathes of wholesale financial markets. As you all know, foreign exchange markets were one area where it was clear that corrective action was needed. And that is why the BIS Governors took the initiative to sponsor the development of the FX Global Code,[2] which was launched in May of this year.[3]

The Code's objective is 'to promote the integrity and effective functioning of the wholesale FX market', where diverse participants can 'confidently and effectively transact at competitive prices.' This is no small task, and my main focus today is on what needs to occur over the next year or two to further this aim.

But before doing so, let me recap where we have got to, drawing out how the complexity, diversity and dynamism of the FX market influenced the development of the Code we are looking to embed. That complexity arises both from its uniquely global nature and from the variety of ways in which participants can transact, with no single trading venue, or even single method of trading dominating. Participants range from corporates looking to hedge their trade flows, through to principal trading firms reacting to the most transitory of pricing anomalies. Some access the wholesale market directly, others indirectly through the sponsorship of their prime broker. And the market itself is constantly evolving, as service providers respond to the ever-changing requirements of market participants and the external environment in which they operate. That pace of change shows little sign of slowing; indeed one of the strengths of the FX market is its innate dynamism.

Faced with these features, those of us involved in developing the Code quickly decided that it had to be based on a set of high-level principles. This enabled us to cut through much of the complexity within the market and should result in the Code providing greater constancy in advice than a detailed set of rules could achieve in such a fast-moving market.

[1] See *Settlement Risk in Foreign Exchange Transactions* (1996), known as the *Allsopp Report*, prepared by the BIS Committee on Payment and Settlement Systems (CPSS); www.bis.org/cpmi/publ/d17.pdf.
[2] http://www.bis.org/press/p150511.htm
[3] www.globalfxc.org

The diversity of the market also led us to deploy a uniquely collaborative approach when developing the Code, with officials from central banks across the globe working with senior representatives from sell side, buy side, non-bank participants and infrastructure providers. Feedback was also sought from members of the various regional foreign exchange committees. The aim – which I firmly believe we met – was to publish a Code that was well informed by the full diversity of market participants and had the legitimacy to be adopted voluntarily.

It will be important to maintain that collaborative spirit as we move forward. The Global Foreign Exchange Committee, or GFXC, was formed to facilitate exactly that. The Committee, which I currently chair, comprises public and private sector representatives from 16 of the largest FX trading centres, and has a mandate to promote and maintain and the Code. As a global body, an early task will be to respond to the desire of other regional FX markets to associate themselves formally to the Code, and I hope to agree an effective mechanism at our next meeting in November.

The voluntary nature of the Code means that transparency of adherence and peer expectation will play a key role in furthering its broad adoption. The short Statement of Commitment appended to the Code provides a means for firms to publicly demonstrate their support, and the GFXC has issued guidelines for organisations interested in developing public registers to make these easy to find.[4] If individual firms come to expect that counterparts will have committed to the Code, and have the means to see whether that is the case, then the Code will become woven into the fabric of the market. Central banks are taking a lead on this, reviewing their own practices and setting clear expectations with their FX counterparts.

Three months after launch, I'm encouraged by some of the early signs of adoption within the private sector too. Interest has spread far and wide, with some 20,000 individual downloads of the Code so far. Around 10 market participants have already published commitment statements and many others have publically affirmed their intentions to do so. The development of public registers, too, is in progress – the first was launched last month and I understand other organisations are actively considering following suit.

Seeking broad adoption

So if we have reached the point where a new Code has been launched and there are encouraging early moves on adoption, what needs to follow? Most obviously, it's important that we maintain this early momentum so that adoption becomes the norm.

As I have already implied, virtually all of the firms directly engaged in developing the Code have publically stated their intention to sign up, and members of the various central-bank organised foreign exchange

[4] http://www.globalfxc.org/public_registers.htm?m=62%7C379

committees across the globe will do so too. This captures many of the large sell side firms and infrastructure providers.

The challenge at this stage is to ensure that firms engaging in the full range of wholesale market activities are equally committed to incorporating the Code into their business practices.

The audience in this room represents a key constituency: buy-side participants. A traditional, though I hope fading, attitude is to view codes of conduct as the preserve of sell-side firms only. But the Code provides key guidance that is relevant to both sides of any FX transaction. Moreover, an objective behind providing principled rather than rules-based guidance was to encourage market participants to think through how those principles apply to their own business context, and to apply the Code in a manner which is proportionate to that context. There are elements of the Code that speak specifically to participants that act as clients: the ninth principle, for example, notes that clients should be aware of the risks associated with the transactions, and regularly analyse their execution. The Code also empowers buy side firms to ask the right questions of their trading counterparties, for example what type of market colour they can expect to receive, and the appropriate transparency that should be provided around execution practices. And from my perspective it is important that buy-side firms ask those questions, as your informed, engaged, participation is vital to market integrity.

A second key constituency that needs to embrace the Code is the range of newer market participants that have become increasingly important in recent years. Most notable perhaps is the entrance of non-traditional market makers – particularly principal trading firms – who can play an integral role in mobilising liquidity across the fragmented array of venues. Newer entrants like these may not have been caught in the mire of conduct issues that galvanised the work on the Code in the first place, but their commitment would enhance the Code's success. In turn the Code's success will be to their benefit: clearly defined expectations about good market practice level the playing field and are supportive of innovation. More generally, as the new entrants gain market share, they should recognise that increasing numbers of their counterparts are likely to expect them to demonstrate commitment to good conduct.

The Code benefits all participants in the FX market, from asset managers to PTFs, who should recognise this, show their support and sign up to the Code.

Keeping pace with an evolving market

If the first task is to promote consistent and widespread adoption of the Code, the second is to ensure the Code itself continues to provide relevant guidance. The job of the GFXC is to ensure this happens.

On occasion the GFXC may judge that broad public feedback is needed on particular topics or market trends to achieve its objectives. The first such example is the Request for Feedback on Last Look practices that the GFXC launched in May.[5]

The Code has already made a significant step forward in setting out a common understanding of what last look is and how it should be used fairly, in line with its proper purpose as a risk control mechanism. It also sets out guidance on appropriate transparency around its use, for example by engaging in regular dialogue with clients on how their orders are handled. And anecdotally, as in many other areas of the Code, the discussions held during its development have already spurred some industry changes which have led to greater transparency.

The most challenging area though was agreeing on the guidance that should be provided with regards to the specific topic of trading activity in the last look window.

What is clear to me is that there is – at the very least – the *potential* for misuse of this specific feature, as various ongoing misconduct cases bear testament to. The Code already provides guidance that is designed to minimise the risks of that misconduct occurring. The underlying debate, which our consultative process seeks to resolve, is whether there are ways of reducing those risks even further. If we can identify specific, legitimate, uses of this type of trading activity, as well as the already well-known illegitimate uses, we can then cater for both within the Code. But if the evidence suggests that trading in the last look window is simply inconsistent with good conduct, this section of the Code will need to be updated accordingly.

It's impossible for me at this stage to presuppose the outcome. What I want to emphasise is the GFXC's commitment to acting on the evidence we receive. We are fully aware that the Committee's eventual conclusion has the potential impact on some firms' current business models, and that is why we are committed to establishing the broadest possible evidence base on which to take our decision.

There are nine days remaining before the feedback window closes, and I encourage all of you – both price makers and takers – to provide us with your views.

While the last look debate is the current centre of attention it is important to recognise that over time the Committee will need to update other areas of the Code. In some cases these might amount to tweaks to avoid unintended consequences; in other cases they will be in response to further evolution in the market itself. And although crystal ball gazing is always a perilous exercise, if you take the agenda for this conference as a guide, then one area likely to remain in focus in coming years is transparency.

[5] http://www.globalfxc.org/consultative_process.htm

On the one hand the demand for market data will only continue to rise – for example, as end users demand transaction cost analysis tools and analytics to measure the quality of their execution and to predict the optimal time to execute trades. But on the other hand, growing market complexity and greater internalisation of flows tend naturally to reduce the ease with which such data can be accessed. So it's not hard to imagine that post-trade transparency as one of the areas where further guidance may eventually be needed.

Securing success

So far I have focussed on activities: encouraging firms to commit to the Code, investing to ensure it continues to provide up-to-date guidance. Ultimately though, the success of the Code will be judged on outcomes. The aim is to improve market practice and rebuild trust in the FX market – that is what the BIS Governors will be looking at when they come to review progress in three years' time.

Those outcomes are difficult to measure. One positive indicator would be if firms identify and rectify individual misconduct cases quickly. Another would the absence of widespread conduct issues across firms. But we will want also to understand how the Code is affecting market functioning in a deeper sense. To this end, the GFXC plans to survey regularly market participants. This will enable us to track some of the less tangible indications of success, such how the Code is impacting and improving behaviours – transparency around pre-hedging for example – and how the Code is being embedded in the market through firms' adherence expectations of their counterparties. An initial survey will be launched later this month, to give a benchmark against which subsequent survey results can be compared.

I have no doubt of the commitment of many in the market to ensure success. What is needed now is to embed that attitude across the market as a whole and to ensure that our efforts so far translate into real improvements.

Improved culture and attitudes regarding market conduct;

Improved confidence for end users that they are transacting at competitive prices;

And ultimately, a market that more effectively serves its economic purpose.

So in closing I would ask again for your help in achieving that change. The success of the Code will depend above all else on the continued efforts of all involved in the market. Central bankers will remain deeply engaged, but to secure success we will be relying on the partnership with market participants that we have fostered. It has proved powerful in the past, and it is crucial that it continues to do so.