Jacqueline Loh: Implementation of the FX Global Code

Keynote speech by Ms Jacqueline Loh, Deputy Managing Director of the Monetary Authority of Singapore, at the 13th FX Week Asian Conference, Singapore, 23 August 2017.

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Eva Szalay, Editor, FX Week,

Ladies and gentlemen, good morning. Thank you for inviting me to join you at the 13th FX Week Asia Conference. I am very happy to join you today.

The foreign exchange or FX market – which all of you are participants in – is the largest and most liquid of financial markets globally.

- It has grown remarkably over the past few decades. Between 1995 and 2016, a 21-year period, global FX turnover rose from US$1.2 trillion to US$5.1 trillion per day, according to the BIS Triennial FX Survey, representing a compound annual growth rate of more than 7%[1].
- Its importance extends beyond financial markets and participants, and is reflected in how it supports the real economy, forming the backbone of international trade, and cross-border investments.

Looking back, while we have seen healthy growth in volumes, the same cannot be said of conduct. The misconduct that has come to light in recent years, has eroded trust in the FX market.

Looking ahead, for the FX market to continue to grow in a sustainable manner to support economic growth, guiding behaviour in the FX market and anchoring strong culture within firms through good market practice will be key.

This brings me to the FX Global Code and its global implementation, which I will share more about today.

Launch of the FX Global Code

The FX Global Code was launched in May 2017 by the Bank for International Settlements (or BIS).

- It was developed over 2 years by the BIS Foreign Exchange Working Group (or FXWG), which comprised central banks from the key FX jurisdictions.
- The effort was also supported by a public-private partnership between the central banks and active engagement from key FX market participants.
- The private sector participants included the sell-side, buy-side, trading platforms and other market infrastructure.

What we have now is a single, global code of conduct for the wholesale FX market.

Benefits of the Code

How will the Code benefit the FX market?

Let’s take a step back and look at the nature of the wholesale FX market. It is inherently complex:

- Activity takes place across multiple venues; there is no single trading venue and no single price.
- Trading happens 24 hours a day, spanning multiple centres, with the day’s trading starting in

New Zealand, Australia, and moving to Singapore and London as the day progresses, before ending in New York.
- Participation is diverse – with banks, asset managers, corporates, and central banks, each transacting FX to meet different objectives.
- Participants act as principals or agents, and the responsibilities pertaining to each may not be well understood.

Hence, there could be market failures, asymmetry in information and potential conflicts of interests.

Good practices are therefore, essential to guide behaviour in the FX market, and to anchor a strong ethical culture within firms.

The Code will support the nurturing of good practices and in turn, the growth of the FX market across key financial centres, including Singapore.

Unique features of the Code

Codes of conduct have been in existence and are not new. So why will this Code be different?

There are several factors why this may be the case, including:

- what the Code captures;
- who the Code will apply to;
- how the Code was developed and will be maintained; and
- how it will be implemented.

First, the content of the Code is relevant and reflects good practices that should exist in the FX market.

- The Code provides guidance in areas where clarity is needed.
- For example, after the misconduct came to light, many market participants swung to the other extreme and became highly reluctant to share market colour.
- This negatively affected market liquidity.
- The Code includes principles on information sharing, stating explicitly that “the timely dissemination of Market Colour can contribute to an efficient, open, and transparent FX market”.
- Additional guidance has been provided on how to apply this principle e.g. while communications should not include specific client names, aggregated and anonymised information can be shared.
- Both positive and negative examples also provide additional practical guidance.

Second, it will apply to all market participants.

- Previous codes were catered to sell-side participants.
- This Code extends to all wholesale market participants – sell-side, buy-side, non-bank market makers, trading platforms and market infrastructure.
- A question that we have been asked frequently comes from buy-side participants – Why does the Code matter to me?
- The application of the Code to all wholesale market participants, including the buy-side, stems from the belief that good practices should apply to all market participants and not only a subset.

- With widespread adoption, the power of market discipline and peer pressure can be immense.
- This is important for a voluntary Code.

The Code incorporates the principle of proportionality, given the diverse nature of market participants.

- What this means is that not every principle will apply directly to every market participant.
- In the case of a buy-side participant, you will find that only a portion of the principles have direct applicability.
- For example, most of the principles relating to execution are directly applicable only to sell-side participants.
- Hence, the implementation burden may not be as significant as one would expect.

Nevertheless, while the rest of the principles may not have direct applicability, they provide clarity to your counterparty relationship with the sell-side.

- By understanding the practices that your counterparties are abiding by, it informs what you should expect from the counterparty relationship.
- For example, in the hotly debated issues of mark-ups and last look, the good practices help you make more informed choices in selecting and interacting with your counterparties.
- While we were initially less optimistic about buy-side adoption relative to the sell-side, our outreach efforts have indicated that once the buy-side sees the benefits the Code brings, they become enthusiastic adopters.

The third reason why this Code will be different, is that it was developed by an unprecedented public-private partnership, and will be kept relevant over time.

- The development process for the Code was an intense and inclusive one, involving the participation of a wide range of market participants.
- Hence, we expect strong buy-in from market participants.

This partnership also recognises the importance of keeping the Code relevant over time.

- Moving forward, the Code will be collectively owned and maintained by the local Foreign Exchange Committees (or FXCs), through the Global Foreign Exchange Committee (or the GFXC).
- The GFXC was launched in May this year, together with the publication of the Code.
- The GFXC, comprising members from key central banks and private sector market participants, will assess regularly if there are new market developments that should be included into the Code.
- It will also oversee a comprehensive review of the Code on a less frequent basis, keeping the Code relevant over time.

Fourth, extensive outreach to market participants has been done and will continue.

- Over the past two years, extensive outreach was undertaken to more than 120 sell-side and buy-side industry associations, and key market infrastructure globally.
- The response has been positive.
- These efforts by the GFXC, central banks and local FXCs, to raise awareness and encourage adherence to the Code, will continue.

Supporting adherence

While the above reasons provide a strong foundation for the Code to succeed, the success of the Code will depend on widespread adherence by market participants.

Hence, we should each ask ourselves what we can do to support adherence.

There are three key elements in the adherence framework developed by the FXWG, which can support adherence at both the individual firm and industry levels.

First, the Code has to be embedded into your practices.

- Training and education of staff will be particularly important to effectively embed the Code.
- There are ongoing initiatives at the firm level, and the industry should consider if there are system-level initiatives that could make sense. For example, industry associations could consider developing relevant training content that caters to specific segments of the FX market e.g. buy-side players or corporate treasuries.

Second, there should be effective monitoring on how successfully the Code has been embedded.

- To this end, a number of adherence mechanisms have been developed to facilitate effective monitoring.
- For example, at the system level, the GFXC will use a broad survey of market participants to monitor adherence and adoption.
- The survey will take place annually and the first survey will be conducted in 4Q this year, to form the baseline for monitoring progress.
- At the firm level, we expect that mechanisms will be put in place to monitor how the Code has been embedded within internal practices.

Third, firms should be able to demonstrate publicly that their conduct in the FX market is in line with the Code.

- A key part of the Code is the Statement of Commitment that is found in Annex 3 of the Code.
- This is a single, common basis by which each market participant can demonstrate that it commits to adhere to the Code[2].
- It will be up to each market participant to decide whether and how to use the Statement. For example, some market participants may choose to publish their Statement on their websites, or provide a copy to counterparties when establishing trading relationships.
- Thus far, a number of the largest FX market participants have indicated that they will be signing the Statement by May 2018.

The industry is also considering the development of public registers, which are essentially repositories where market participants can publish their Statements.

- Public registers can enhance transparency around the level of adoption of the Code, and can be a means to monitor the success of the Code over time.
- Feedback from market participants has indicated that there is a demand for public registers.
- Market participants that have signed the Statement can publicly demonstrate that they have done so on such public registers.
- Market participants can also use public registers to find out which of their peers or counterparties have signed the Statement.

We have heard that CLS, has established a public register on their website, where CLS members are able to post their Statements to publicly demonstrate adherence to the Code.

The BIS Governors have asked the BIS Markets Committee, which I currently chair, to assess the effectiveness[3] of the Code over time.

- This will likely take place 3 years after the launch and will be conducted together with the GFXC.
- This is a demonstration of the BIS Governors' ongoing commitment to the Code.

Embedding, monitoring and demonstrating adherence are actions that we hope that you will take to support adherence of the Code.

- As a first step, I strongly encourage all of you to read the Code. You will find that it is written in simple language and addresses many issues where there were previously no guidance on.
- Consider how it can be applied to your firm, taking into account proportionality – i.e. how the principles are embedded must be in the context of the nature and the significance of your activity in the FX market.
- Consider how you can encourage counterparties to adhere. It would be a positive outcome if it becomes a norm that each new counterparty relationship starts off by bilateral indication that both parties adhere to the Code.

Central banks leading the way

We, in our capacity as central banks, will lead the way.

- The central bank Governors of the BIS Global Economy Meeting, in their press statement of 25 May 2017, welcomed the launch of the Code, and confirmed their intention to embed the Code within their own practices[4].
- In addition, given the increasing volume of FX activity taking place in Asia, the Asian central banks, including MAS, HKMA, Bank of Korea, the Reserve Bank of Australia, and the Reserve Bank of India also expressed support for the Code and will be engaging local participants to promote adherence to the Code.
- MAS, in our capacity as the central bank, is also in the process of embedding the Code within our practices.

The central banking community has also considered our possible areas of influence.

- There are two such areas.
- The first is that we will encourage our FX counterparties to use the Statement; and
- The second is that we will make Code adherence a condition for membership to our respective Foreign Exchange Committees.
- The likely impact of these initiatives can be powerful – the major regional FXCs have more than 200 members within them – and these are amongst the largest participants in the FX market.

So what is Singapore's approach to the Code?

- Singapore is now Asia Pacific's largest FX centre.
  - The average daily turnover in Singapore exceeds US$0.5 trillion[5].
  - We have registered 11.7% CAGR growth over the last 6 years, and account for about 8% of global turnover.

- This is supported by a growing ecosystem of banks and non-bank financial participants, asset managers and corporate treasuries, who have chosen to base their FX activities here.

- As the preeminent FX centre in the Asian time zone, which serves the different investment and hedging needs of market participants, it is important that Singapore play a leading role in adopting Code.
- Within Singapore, the Singapore Foreign Exchange Market Committee ("SFEMC"), will take on the responsibility to promote and encourage adherence to the Code.
- As a start, SFEMC members, comprising key sell-side banks and buy-side participants, will be using the Statement of Commitment to demonstrate their commitment to adhere to the Code.
  - SFEMC will also be the key platform to collect feedback and views on evolving issues that could be brought to the GFXC and included into the Code over time.

- In terms of outreach, we will leverage on a public-private partnership approach to engage our market participants.
  - MAS and SFEMC members have been actively engaging market participants through both sell-side and buy-side associations, and will continue to do so.
  - These include the Association of Banks in Singapore (ABS), the Investment Management Association of Singapore (IMAS) and the Association of Corporate Treasurers (ACTS).
  - If you have good ideas to share, on how we can do this more effectively, please reach out to us.

Conclusion

The Code is a tool to rebuild trust in the FX market, and we are confident that it can achieve its full potential with your support.

- Together, we can raise standards, professionalism and accountability of market participants within the FX market in Singapore and globally.

On that note, I hope that you will have good discussions and a fruitful conference ahead.

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1 Source: BIS Triennial FX Surveys.

2 By signing the Code, a market participant represents that it (a) supports the Code and recognises it as a set of principles of good practice for the FX market; (b) is committed to conducting its FX market activities in a manner that is consistent with the principles of the Code; and (c) 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.

3 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.

4 BIS press release, 25 May 2017, "Central bank Governors welcome global code of conduct for currency markets"

5 Source: 2016 BIS Triennial FX Survey.