

THE NEW CODES OF CONDUCT



IT'S CRUCIAL FOR TREASURERS TO KNOW THE DIFFERENCE BETWEEN FSA RULES AND THE NIPS CODE. **BRIAN WELCH** OF THE USERCARE TREASURY CONSULTANCY GETS TO GRIPS WITH THE TERMINOLOGY.

Now may be the time for your annual bank relationship review, or perhaps to establish some new counterparty relationships. In either case, you may receive a detailed letter or document referring to the *Financial Services Authority (FSA) Handbook* and an apparently brusque announcement that your bank has decided to classify your company as an 'intermediate customer'.

If you are not familiar with the terminology, the safe option is to pass this kind of formal notice to your firm's in-house lawyer, who will take one look at it and probably put it to the bottom of the pile. The purpose of this article is to save you from your in-house lawyer (or the cost of an external one) and to provide the re-assurance that:

- 'intermediate customer' classification isn't an insult;
- that is where you want to be; and
- to provide a brief insight into the new codes, highlighting the relevant parts for treasurers.

The Financial Services and Markets Act 2000 (FSMA) is the legislation which formalises the establishment of the FSA. Its new codes of practice came into play on 30 November 2001 (known, for some reason, as N2). A huge amount of work went into producing the new FSA rulebooks, and the Association of Corporate Treasurers (ACT) was consulted during their preparation.

Of more immediate importance to businesses were the changes to the London Code of Conduct, responsibility for which was transferred from the Bank of England to the FSA in June 1997. Its replacement, the Non-Investment Products (NIPS) Code, has been drawn up by a wide cross-section of market participants, including the Bank of England and the FSA, and is overseen by the Bank.

THE NIPS CODE

The old London Code of Conduct covered money markets, foreign exchange and bullion, and its replacement's new name has the catchy acronym of the NIPS Code. Again, the ACT was actively involved in its development and, although the language and the format has changed, the underlying principles are broadly similar to

the previous ones. The main part, and the relevant annexes has been included in the *Treasurer's Handbook*, the full version of which can be found on the Bank of England website on www.bankofengland.co.uk/markets/nipscode.pdf.

It is important to emphasise that most day-to-day corporate treasury transactions, namely short-term deposits and loans, and foreign exchange transactions, are covered by the NIPS Code and are specifically excluded from the FSA Handbook.

However, the letters and agreements being sent out by the various banks concentrate on the FSA rules and tend to make little more than a short, passing reference to the NIPS Code.

In recent years, the derivatives industry has tried to inflate its importance by counting forward FX transactions as part of its market share. For the avoidance of any doubt, however, straightforward forward FX transactions are covered by the NIPS Code. The more complex derivatives – swaps, options and futures – are governed by the FSA rules. The NIPS Code describes the standards of business conduct in the financial markets. It covers three areas:

- general standards;
- controls, and confirmation and settlement; and
- areas of particular interest to treasurers, which we will go into in more depth below.

DEALERS' EXPERIENCE AND TRAINING. The Code emphasises that any dealers must have the authority to commit their company to the various transactions. It requires that they are adequately trained, and that they are both familiar with and comply with the Code, as well as any other regulatory requirements (NIPS Code, Paragraph 11).

DEALING MANDATES. There are references in the main body of the Code and in Annex 1 to the benefits of using dealing mandates, as long as they are not used to pass unreasonable responsibilities to another counterparty. Occasionally, some banks try to avoid accepting mandates from companies, but the ACT continues to regard their use as best practice, and the continued reference to them in the NIPS Code supports that recommendation (NIPS Code, Paragraphs 26, 27, 89 & 90).

CONFIRMATIONS. The prompt exchange of confirmations and independent checking for all transactions is important for avoiding errors and preventing fraud. From time to time, the banks express concern that companies do not send out confirmations promptly after dealing, and the ACT recommends that its members should conform with the best market practices so as not to put this privileged position at risk. Time is of the essence in sending out confirmations, because the sooner errors are identified, the less the likely cost of putting them right. The Code says that it is good practice to check confirmations within a few hours of receipt. Corporates sometimes combine the signature of confirmations with their internal authorisation process, which can create major delays in the absence of the appropriate manager to sign a confirmation letter. Banks rarely sign their confirmation letters, and there is no need for corporates to insist on doing so, especially if that delays the process. Confirmations are not necessary, however, for transactions agreed using electronic dealing systems (NIPS Code, Paragraphs 57, 58, and 108 to 117).

TAPING OF TELEPHONE CONVERSATIONS. The taping of telephone transactions is regarded as normal practice by the Code, and is used by all the banks, to assist with the resolution of differences and disputes, and to identify and discourage 'inappropriate behaviour'. Where practicable the ACT encourages its members to record their own dealing conversations rather than rely on the systems used by their banks (NIPS Code, Paragraphs 30 to 36).

DISPUTES. The Bank of England used to be willing to arbitrate in disputes concerning transactions, although just the threat of its involvement usually meant a sensible compromise was reached. Because the Bank now has only a limited and non-supervisory role, this facility is now offered by the Bank of England Foreign Exchange Joint Standing Committee, of which the ACT is a member.

FUTURE DEVELOPMENTS. The Code will continue to be amended from time to time to take account of changes and standards, such as improved transparency, and to cater for further developments in electronic dealing. The NIPS Code has no legal standing, except where it refers to legal requirements, but any infringement "may raise issues about a firm's integrity or competence".

In addition, it applies to all money market transactions undertaken in London, irrespective of the location of any of the parties. Companies based outside of the UK, but dealing in the London Market, are therefore subject to the Code.

THE FSA HANDBOOK

The letters and agreements being sent out by counterparty banks focus mainly on the FSA rules because they are much more specific and probably in the hope that the company will undertake more investment transactions with them. The rules aim to cover everything, including aggregation, allocation, risk warning notices and stabilisation – all of which is interesting but not really applicable to corporate treasury transactions.

The term 'investment products' covers the full range of market investments, including equities, bonds and other related instruments that the company will be involved in issuing from time to time but which they are less likely to purchase. The term also covers derivative products, certificates of deposit (CDs) and commercial paper (CP), which a treasury is more likely to use.

'PROBABLY ONE OF THE MOST NOTEWORTHY DIFFERENCES FOR COMPANIES BETWEEN THE NIPS CODE AND THE FSA HANDBOOK IS THE ABSENCE OF ANY REFERENCE TO MANDATES IN THE HANDBOOK'

INTERMEDIATE CUSTOMERS. When the new FSA rules were being developed, it was agreed that companies would be categorised as 'intermediate customers', although they also have the right to opt up or down, to different categories as they wish.

The intermediate category is designed to cover the occasions when a company might deal in investment products, such as CDs or short-dated gilt-edged stocks, swaps, options and futures. In addition, companies also have the right to opt for different categorisation for different products so that they can accept the intermediate category for the instruments they understand, such as CDs, gilts, swaps and options, yet opt for the private customer category for products that are used less often, such as futures.

There are two other categories. Market counterparty, which is for the high-activity market operators (rarely the case for corporates or private customers). If companies are classified as private customers, they will be required to provide a lot more information to the bank before each and every transaction, about their specific circumstances and reasons for undertaking a transaction, before each and every one.

The banks have a responsibility to private customers to ensure the product they are providing is suitable for them and their circumstances, while companies usually want to deal quickly and do not normally want to share confidential information about their circumstances.

Probably one of the most noteworthy differences for companies between the NIPS Code and the *FSA Handbook* is the absence of any reference to mandates in the handbook. This is probably because in the investment markets there are a much larger number of individual clients and the banks claim it would be difficult to keep track of the details of authorities for all of them. It also emphasises the special dealing relationship companies have with the banks in the money markets.

Market counterparties are covered by a different rulebook, the Inter-Professional Code (IPC), which contains some abbreviations that may seem a little obscure. Private customers and intermediate customers, meanwhile, are covered by the *Conduct of Business Sourcebook (COBS)*.

It is crucial treasurers understand the importance of the NIPS Code, and the differences from the FSA rules, as they affect corporate transactions. The intermediate classification being given to companies by their banks is the correct FSA status which the Association intended, but 'plain vanilla' foreign exchange and money market transactions are covered by the NIPS code.

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