Codes of conduct in the wholesale markets

New legislation will make significant changes in the regulatory environment for treasurers. The Association's Caroline Bradley explains the issues.

At present, most corporate treasuries dealing in the wholesale markets operate in accordance with the London Code of Conduct (LCC) which is endorsed by the Association as its guide to best practice in these markets. The most relevant sections of the LCC are summarised in the Technical Guidance section of *The Treasurer's Handbook*.

This states: 'The purpose of the LCC is to set out the principles and standards which broking firms and 'core principals' in the wholesale markets and their employees should observe. While the LCC is considered best practice for corporate treasurers it is mandatory for some treasury operations. These operations are those carried out by treasuries designated as 'permitted persons' under the Financial Services Act, where compliance with the LCC is a condition of the permission. In all cases, however the corporate treasurer must recognise that when dealing in the wholesale markets, the banking counterparties have the right to assume that the company is dealing as a market professional with an understanding of the main elements of the code.'

New regime

Under the new Financial Services and Markets Bill, which should come into effect before the end of 2000, the situation will be rather different.

Those companies currently operating as 'permitted persons' will be aware that this way of gaining exemption from authorisation will no longer be available. Companies will need to decide whether they should continue the relevant activities (eg, trading in commodities) and become authorised or whether to stop such activities. Treasurers will have to take advice, but it is thought that the number of companies that actually need the 'permitted persons' exemption is very small and many have adopted it as a protection against unwittingly carrying on a regulated activity.

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There are two other very significant changes in the new regulatory environment that will affect treasurers.

Firstly, there will be separate regulation of investment and non-investment products and treasurers will need to be clear about which category any particular transaction belongs to.

- Non-investment products are money market deposits and spot and forward FX. These markets will be supervised by the Bank of England under a code of conduct which, although not yet developed, is likely to be very similar to the LCC. This will be called the Non-Investment Products code, or NIPS.
- Investment products are everything else, from certificates of deposit, commercial paper, swaps and options up to equities and corporate finance. These markets will be regulated by the FSA under two sets of rules depending on whether the corporate counterparty is operating as a customer or a market counterparty (MCP), ie a professional.

Secondly, far from banks having to assume (as at present) that corporates dealing in the wholesale markets are operating as market professionals, this will become absolutely clear. Under the new FSA regime, all corporate counterparties will be categorised as 'intermediate customers' unless they opt up, by agreement with any particular bank counterparty, to MCP status. It is likely that larger companies will decide to opt up for some or most (but probably not all) investment products. As an intermediate customer, corporates will have customer protections under the Conduct of Business Sourcebook (COBS) rules. As a MCP, they will have very few protections with transactions being governed by the Inter-Professional Code (IPC).

The opt-up process

Although in many ways the situation will be clearer, the disadvantage of the new system is that treasurers will need to be alert to the possibility that any particular transaction could be governed either by one of two codes (NIPS and IPC) or by the COBS rules. Since the opt-up process is between a company and a bank, the same type of transaction conducted with two banks would be governed by different rules if the company had opted up with one bank but not the other.

It is expected that the Association will endorse NIPS and IPC as its guide to best practice in the wholesale markets for non-investment and investment products respectively. Although neither the two codes nor COBS are yet finalised, the general shape and content is now clear.

The Association has participated in working groups and is responding to consultation papers to ensure that the three are consistent with each other and that they give treasurers the necessary protections and guidance.

Key issues

The Treasurer's Handbook identified those sections of the LCC that were particularly important for treasurers:

- **dealing with brokers** – the LCC guidance is likely to be included in both IPC and NIPS;
- **taping dealing conversations** – as noted in last month's Technical Hotline, market practice is moving away from taping and the EU ISDN directive, which will prohibit taping in certain circumstances, is due to come into force later this year. It is not clear how the directive will be implemented by the UK government;
- **deals at non-market rates** – it seems likely that this will be covered in all three. The draft IPC provisions have been developed from the LCC but no longer require senior level sign-off from a counterparty; and
- **dealing mandates** – the existing LCC guidance on mandates is omitted from the draft IPC because mandates are a customer issue and customers are outside the scope of IPC. It might appear as part of COBS. We have written to the FSA suggesting that guidance on mandates is included in both IPC and COBS but it is evident that banks are increasingly unable or unwilling to check mandates when dealing in wholesale products. Whether or not we succeed in persuading the FSA to include suitable wording, treasurers should not rely on bank mandates as a substitute for adequate internal controls.

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Clearly there are some important issues still to be settled in the next few months. Regular updates on the development of the new regime will be found in Technical Hotline and on the Association website. In addition, an updated section on codes of conduct will be found in next year's edition of *The Treasurer's Handbook*. ■

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