A NEW CODE FOR FX

A NEW GLOBAL CODE OF CONDUCT FOR THE $5.1 TRILLION A DAY FX MARKET WAS UNVEILED IN MAY TO IMPROVE TRANSPARENCY. NEILL PENNEY EXPLAINS ITS TREASURY IMPACT, HISTORY AND MAIN STIPULATIONS

Corporate treasuries need to move money around the world and hedge their currency positions to protect profits and costs. But as infrequent users of the FX market, they tend to rely on their banks or infrastructure providers to transact their daily or weekly trades, and to ensure they get the best deals for spots, forwards and other types of FX financial instruments.

As such, corporate treasurers were shocked when the FX market rate fixing (WMR) scandal broke in 2014, revealing they had been paying over the odds for FX for several years due to a market that had been manipulated by traders at different banks, in a similar fashion to the Libor market where a false benchmark imposed extra costs.

Large fines ensued, with seven banks paying out more than $10bn in total between 2014 and 2015 over claims they had misused information and rigged currency benchmarks. Just this year, one bank paid $136.9m in April and another $246m in July, as other financial institutions continue to settle FX malpractice claims with authorities.

The veracity of 'last look' practices that allow a market maker to back out of a trade or reprice it having potentially unfairly learned about a counterparty's intentions have also been questioned, alongside pre-trade hedging procedures and 'front-running'. This is where advanced knowledge of a trade leads to manipulation.

FX Global Code of Conduct

A new FX Global Code of Conduct was unveiled on 25 May 2017 to try to restore confidence in the market. The voluntary guidelines, developed by central bankers on the Foreign Exchange Working Group (FXWG) in partnership with private-sector Market Participants Group (MPG), headed up by CLS chief executive David Puth, aims to deliver: "a robust, fair, liquid, open and appropriately transparent global FX marketplace".

The code covers all market participants, the sell- and buy-side, including any corporate treasuries that are "active in FX markets as a regular part of their business", and those engaging in external trades. Transaction platforms such as FXall are covered, too.

But, importantly, the voluntary code is proportional. The compliance burden should therefore be less onerous on low-volume treasurers, as they're not typically doing speculative or profit-seeking trades. Indeed, as an end user, corporates should benefit from improved behaviour in the market and, hopefully, the elimination of scandals.

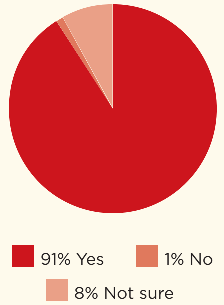
The code is the industry's last chance to self-regulate. Regulators have made it clear that if there is any future crisis involving FX, then a formal prescriptive legal framework for the operation of the market will follow.

The new rules will be maintained and updated by a new Global Foreign Exchange Committee (GFXC). The code contains six core principles, with numerous sub-stipulations, meaning there are 55 guidelines in total. The core principles in the 78-page GFXC Code of Conduct[1] are:

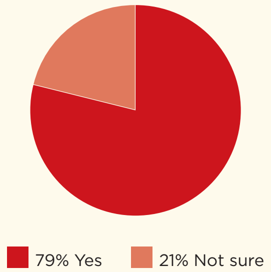
1. **Ethics:** "Market participants are expected to behave in an ethical and professional manner to promote the fairness and integrity of the FX market."
2. **Governance:** "Market participants are expected to have a sound and effective governance framework to provide for clear responsibility for, and comprehensive oversight of, their FX market activity, and to promote responsible engagement in the FX market."
3. **Execution:** "Market participants are expected to exercise care when negotiating and executing transactions in order to promote a robust, fair, open, liquid and appropriately transparent FX market."
4. **Information sharing:** "Market participants are expected to be clear and accurate in their communications, and

SUPPORT FOR THE CODE

Will you expect your banks to be adherent to the code?



Do you feel it's important that the corporate treasury community is seen to publicly support the code through adherence?



SOURCE: *169 FINANCE OR RISK PROFESSIONALS,* THOMSON REUTERS POLL, FEBRUARY 2017

to protect confidential information to promote effective communication that supports a robust, fair, open, liquid and appropriately transparent FX market."

5. **Risk management and compliance:** "Market participants are expected to promote and maintain a robust control and compliance environment to effectively identify, manage and report on the risks associated with their engagement in the FX market."
6. **Confirmation and settlement processes:** "Market participants are expected to put in place robust, efficient, transparent and risk-mitigating post-trade processes to promote the predictable, smooth and timely settlement of transactions in the FX market."

One of the key points in the global code is that conduct is not just about good behaviour, although this is important and should be positively impacted by enhanced mark-up transparency and other such changes. However, the code is also about introducing good practice to ensure the market operates smoothly and effectively, minimising disruptions due to things like poor data sharing or mis-confirmations, so although this isn't formal regulation, it will shape the FX market for years to come.

Adherence

The code also tackles complex topics, such as electronic trading, algorithmic trading and prime brokerage. In addition, there is a separate nine-page adherence[2] document. This is designed to help migration to the new code, which sets out how to demonstrate and publicly declare that you're following it, should you choose to do so, via a standardised 'Statement of Commitment'. These may be collated on to a public register, if a market participant decides to introduce one.

The ACI (Financial Markets Association, based in Paris) has already come out in support of the code by saying it will make it a requirement for its 9,000+ members to commit to adherence.

Corporates need to be aware that there will be some changes in the way your bank trades with you

"All of us recognise the need to restore the public's faith in the FX market," said FXWG chair Guy Debelle, who is also the Reserve Bank of Australia deputy governor, in a statement released on 25 May to coincide with the code's unveiling.

Debelle added he hopes the code will help "improve market functioning", while CLS's Puth, speaking on behalf of the MPG, said: "It is now up to each of us to follow through with our commitment to adopt these principles."

Thomson Reuters is a keen supporter of the new code and has produced several articles that explain the code; how it relates to us in regard to our matching and FXall execution platform; and our compliance with it. Training will be provided to all our internal FX staff and we may consider offering this service to external corporate treasury partners that use our analytics, execution and other services, if there is sufficient demand for it.

Treasury impacts

Corporates need to be aware that there will be some changes in the way your bank trades with you and in general market practice as a result of the evolving code. You should read it to familiarise yourself with its full contents and remember that it will continue to develop as it is principles-based.

The proportionality elements in the code mean that not all the guidelines will apply to you, but a gap analysis may be beneficial to identify where they do, and any potential changes needed to everyday procedures, alterations to auditing, and so on.

The main consideration for treasurers is likely to be the extent to which you publicly declare your support for the code or not, in order to reinforce good conduct and behaviour in the industry. The individual who will sign the Statement of Commitment from your organisation will also need to be decided, if the conclusion is that you wish to make your adherence public. You'll also likely want to check if your partners and counterparties adhere to the code before deciding if you wish to transact with them.

A survey carried out in February this year by Thomson Reuters during a live webinar that attracted 169 heads of treasury, risk managers, directors and others from the US, Germany, Switzerland, the UK, Canada and other global treasuries suggests that most corporates want to show their support for the code. Live polling of the attendees showed that 79% think it's important for the treasury community to be seen to publicly support the code via adherence. Most also expect their banks to comply, with 91% stating they expect them to adhere to the new code.

The development of the code was initiated by the Financial Stability Board's 2014 investigation into the WMR scandal and has been carried out under the auspices of the Bank for International Settlements[3]. It should presage a revolution in the way the FX market operates and, as such, is worthy of treasurers' immediate attention.

1 www.globalfxc.org/docs/fx_global.pdf
2 www.bis.org/mktc/fxwg/adherence_report.pdf
3 www.bis.org/publ/rpfx16fx.pdf

Neill Penney is managing director and global head of trading, Thomson Reuters

THOMSON REUTERS