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FX Global Code

Post-Publication Commentary

May 31, 2017

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What is the Global Code?

- The **Global Code** aims to be a single set of global principles of good practice for the wholesale FX market.
- The Global Code was developed to provide a common set of guidelines to promote the integrity and effective functioning of the FX market and by unifying disparate codes of conduct from different jurisdictions.
- The effort to establish a Global Code was launched by the Bank for International Settlements, the central banks’ central bank, as an effort to prevent future abuses in a market that has never been formally regulated.

Who participated in developing the Global Code?

- The Global Code was developed by a partnership between central banks and Market Participants from 16 jurisdictions around the globe.
- On the central bank side, the Foreign Exchange Working Group (FXWG) was established to facilitate the Global Code's creation and adoption, and is composed of senior officials from 21 central banks.
- On the private sector side, the FXWG formed a Market Participants Group (MPG) to help coordinate the regional foreign exchange committees and other representatives of the FX market to engage a broad and diverse set of Market Participants in the process of developing and promoting the Global Code.

Why should I care about the Global Code?

- The Global Code does NOT impose legal or regulatory obligations on Market Participants, nor does it substitute for regulation.
- The Global Code is intended to supplement local laws, rules and regulation by identifying global good practices.
- The scope of the Global Code is broad; entities of all types that are involved in FX activities are covered.
- There may be commercial (if not legal or regulatory) pressure to adhere.

Who is a "Market Participant"? Does the Global Code apply to me?

- A "Market Participant" is defined as any type of organization that engages in wholesale foreign exchange activities – all (including their personnel) are included within the scope of the Global Code.
- These include:
  - Dealers and other financial institutions
  - Central banks
  - Asset managers and hedge funds
  - Corporate treasury departments
  - Benchmark execution providers
  - Brokers
  - E-trading platforms
  - Affirmation and settlement platforms

How is the Global Code organized? What does it cover?

The Global Code is organized around six leading principles:

- Ethics: Market Participants are expected to behave in an ethical and professional manner to promote the fairness and integrity of the FX Market.
- 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.
- 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.
- Information sharing: Market Participants are expected to be clear and accurate in their communications and to protect Confidential Information to promote effective communication that supports a robust, fair, open, liquid, and appropriately transparent FX Market.
- 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.
- Confirmation and Settlement: 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.

Global Code Discussions – Broad Themes

- The Global Code largely seeks to enhance disclosure and transparency in the FX market:
    - Do the clients and counterparties of Market Participants know and understand what they are doing and why and how they are doing it?
    - Are Market Participants providing sufficient information to their clients and counterparties to allow them to make informed decisions?

Global Code Discussions – Challenging Issues

- Governance
- Adherence
- Principal and agent roles
- Pre-hedging and last look

Governance – Oversight, Supervision and Control

- Adequate and effective structures and mechanisms must be put in place to provide for appropriate oversight, supervision and controls with regard to a Market Participant's FX market activities
- Some Market Participants may struggle to establish such "effective" structures and to determine what "appropriate" supervision may look like
- The nature and complexity of a Market Participant's FX activities may inform these decisions

Adherence

How will Market Participants be expected to adhere to the Global Code?

A Statement of Commitment accompanies the Code:

[Name of institution] ("Institution") has reviewed the content of the FX Global Code ("Code") and acknowledges that the Code represents a set of principles generally recognised as good practice in the wholesale foreign exchange market ("FX Market"). The Institution confirms that it acts as a Market Participant as defined by the Code, and is committed to conducting its FX Market activities ("Activities") in a manner consistent with the principles of the Code. To this end, the Institution 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.

Adherence

How should the Statement of Commitment be used?

- The Statement of Commitment is designed to be voluntary, and to allow Market Participants to use it in different ways:
  - A Market Participant may choose to use it publicly (by publishing it on its website)
  - A Market Participant may choose to use it bilaterally (by providing it directly to current or prospective clients or counterparties)
- Will there be a public repository that will disclose which Market Participants have adhered?

Adherence

Will it be *de facto* mandatory?

- It is possible that membership in certain foreign exchange committees or other industry groups may require adherence.
- There is likely to be commercial pressure to adhere:
  - Clients or counterparties may decline to interact with Market Participants that have not adhered;
  - E-trading platforms may decline to allow non-adhering Market Participants to use their service;
  - Central banks may create an expectation that Market Participants under their regulatory supervision adhere;
  - Central banks will require their trading counterparties to adhere.

Adherence

Legal effect?

- The Global Code does not impose legal or regulatory obligations on Market Participants, and adherence is voluntary.
- However, could a Market Participant that has declared its adherence to the Global Code be subject to private fraud actions by its clients or counterparties for nonetheless failing to comply with the Global Code's principles, or with its own policies?
- Conversely, compliance with industry standards may afford Market Participants some protection from liability; credible global standards of conduct may serve as a first line of defense as a benchmark of a "commercially reasonable" standard.

Adherence

Timing?

- The timing of a Market Participant's adherence will depend on the steps it must take to support the use of the Statement of Commitment, and such timing may vary depending on the size and nature of its FX business.
- Among Market Participants, including central banks, there is an expectation that full adherence by a critical mass of Market Participants may take up to one year or more.

Principal and Agent roles

What is the effect of blurring these roles?

- Market Participants must be clear about the capacity in which they're acting
  - An Agent:
    - Executes orders on behalf of a client pursuant to a client mandate
    - Does not take market risk in connection with the order
  - A Principal:
    - Acts on its own behalf and is under no obligation to execute an order until both parties agree
    - Takes on one or more risks in connection with an order, including market and credit risk

Pre-hedging and Last Look

- Pre-hedging is the management of risk associated with anticipated client orders, designed to benefit the client.
- Last look is a practice whereby a Market Participant receiving a trade request has a final opportunity to accept or reject the request against its quoted price during a last-look "window."
- Neither practice is prohibited by the Global Code, provided that they are conducted with fairness and transparency.

Pre-hedging and Last Look (cont'd)

Pre-hedging:

- Market Participants should only pre-hedge when acting as a principal.
- Market Participants should communicate their pre-hedging practices to their clients, and should pre-hedge fairly and transparently.
- Market Participants should not pre-hedge with the intent of disrupting the market.

Pre-hedging and Last Look (cont'd)

Last look:

- Market Participants should be transparent regarding its last look practices, and should have appropriate governance and controls around the practice.
- Last look should be a risk control mechanism used to verify operational validity and credit sufficiency.

Pre-hedging and Last Look (cont'd)

- Should a Market Participant be permitted to pre-hedge a specific trade request during the last-look window?
  - The Global Code introduces a presumption that doing so is unlikely to benefit the client:
    - "During the last look window, trading activity that utilizes the information from the Client's trade request, including any related hedging activity, is likely inconsistent with good market practice because it may signal to other Market Participants the Client's trading intent…"
  - This principle will continue to be debated post-publication; it was (and remains) the most controversial issue in the development of the Global Code.

What's Next?

- Formation of Global Foreign Exchange Committee (GFXC)
- GFXC request for feedback on last look practices
- Periodic review of Global Code
- Possible public adherence registers/repositories

For More Information:

Please visit:

www.globalfxc.org for additional information about the Global FX Committee and the Global Code

www.fxpa.org for additional information about the Foreign Exchange Professionals Association (FXPA)