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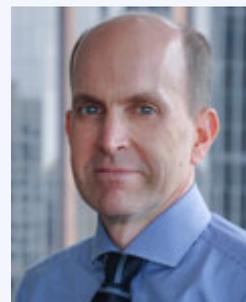
An update on the FX Global Code – Implementation and Principle 17

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Thank you for the invitation to speak here this morning.

It is now almost a year since the FX Global Code (the Code) was launched. Today, I will update you on the progress towards its adoption within the industry. I will also talk a little about the body charged with maintaining the Code – the Global Foreign Exchange Committee (GFXC); how Australia fits into that and what sorts of issues the GFXC has been focusing on. I should note that any views I express today are my own, and not necessarily those of the GFXC or of the Reserve Bank.

Development of the Code

Although I am sure that many of you are now familiar with the FX Global Code, it's worthwhile briefly reviewing its background. [\[1\]](#)

The Code was put together over two years, culminating in its publication last May. Drafting the Code was a collaborative process between private and public sectors globally, with central banks representing the public sector. Guy Debelle – now the Deputy Governor of the Reserve Bank – chaired the process.

The Code is designed to apply to all wholesale market activity, so it was important that a diverse range of private sector participants were directly involved in its composition. This included buy- and sell-side participants from the Australian market. Additionally, throughout the drafting process, the broader membership of the Australian Foreign Exchange Committee also had input. It is this committee – the AFXC – that ultimately endorsed the Code for use in the Australian wholesale market.

The AFXC is sponsored by the Reserve Bank and has existed for many years as the forum through which local industry participants can discuss topical issues in the foreign exchange (FX) market and agree on conventions. Our members are drawn from a wide range of market participants and we have sought to increase that diversity in recent years, bringing in more asset managers and others from the buy side. [\[2\]](#) Similar committees have been sponsored by central banks in other jurisdictions for the same purposes.

Central banks have always viewed these committees as playing an important role in advancing market standards. However, while these committees had endorsed codes of best practice for their respective FX markets in the past, they weren't identical.

The Global Code has been endorsed by the FX committees of all the major currency markets, replacing their old local codes. The committees from the sixteen largest centres – including the AFXC – have also come together to create the GFXC.

The principal task of the GFXC is to maintain the Global Code and promote its adoption within the industry. With FX committees from other, smaller regions also looking to associate with the GFXC, the reach of the Code will continue to expand.

Adherence to the Code

It is important to remember that the FX Global Code isn't regulation and doesn't, by itself, replace any existing legal or regulatory requirements imposed on market participants. The Code is simply intended to provide a common set of guidelines on what constitutes good practice. Nevertheless, the Australian Securities and Investments Commission (ASIC) have encouraged market participants in Australia to adhere to the standards set out in the Code. [\[3\]](#)

As it is a voluntary standard, how confident can we be that market participants globally will adopt the Code and that it will be effective in promoting good practices? Based on what we've seen so far, I think there are good reasons to be optimistic about the Code's success.

First, there is the content of the Code itself. Publishing a Code whose text is informed by the broad spectrum of participants in the market gives it a great deal of legitimacy as an industry standard.

Second, we know that awareness of the Code is now widespread within the industry. Late last year, the GFXC coordinated a global survey of market participants to gauge awareness. The results were encouraging. Most respondents to the survey had a degree of familiarity with the Code and the vast majority thought that the Code would improve behaviours and market practices. [\[4\]](#)

With this awareness comes increasing expectations from clients and counterparts. They want to be sure that the entities they engage with are adhering to the principles of the Code.

Recognising these expectations, the GFXC has appended a short Statement of Commitment to the Code. Market participants can use this statement to publicise their intention to adhere to the Code's principles. Simply put, the statement says that the signing institution has reviewed the Code and has taken steps to align its practices with the principles of the Code.

Over the past year, a number of public registers have been created to record these statements of commitment. For example, in the local market, ACI and the Australian Financial Markets Association (AFMA) have jointly created an online register. [\[5\]](#)

Other registers exist elsewhere in the world and the GFXC will soon put an index of all these registers on its own website. This will include a feature that allows users to search across the registers to check which institutions have signed up to the Code.

At the moment, the public registers indicate that there are over 150 institutions globally that have signed statements of commitment. This number is increasing all the time and is likely to grow rapidly in the next month or so.

When the Code was launched last May, it was recognised that a period of transition might be necessary for participants to align their practices with the Code, or at least review their practices to confirm that they were aligned.

Consequently, when the regional FX committees – including the Australian Foreign Exchange Committee – made membership of their committees conditional on the signing of a Statement of Commitment, members were generally given about 12 months to sign. So that transition period will soon be coming to an end.

Looking over the list of firms that have already signed statements of commitment confirms the global scope of the Code and the breadth of its application in the wholesale market. Not only have the large global banks signed up to the Code, smaller sell-side banks and other liquidity providers have done so as well. Suppliers of key market infrastructure – such as execution and settlement platforms – have also signed.

While it's true that fewer buy-side firms have signed statements, many have done so, including asset managers.

In this regard, it's always been recognised that the steps market participants will need to take to align their practices with the Code will depend on the nature of their FX activities. Some of the principles of the Code may not be relevant for a lot of buy-side firms. However, there are many principles that do provide direct guidance to the buy side, such as considering the potential impact of their orders on market conditions; what sort of market colour clients should, and should not, expect to receive from dealers; and the need for clients to regularly evaluate the execution they receive from dealers.

So, for those of you who are participating in the wholesale FX market, via whatever means, I would encourage you to sign a Statement of Commitment. The success of the Code will be to everyone's benefit and it is important that we all support it.

At the very least, you should be familiarising yourself with the Code and using it as a means of holding to account those with whom you engage in the market. If your counterparts and service providers haven't sent you a signed Statement of Commitment – or lodged one on a public register – you should be asking them why they haven't. In the GFXC's survey of market participants that I

mentioned earlier, a majority of respondents said they were planning to curtail (or even cease) trading with firms that don't sign a Statement of Commitment.

For its part, the Reserve Bank of Australia has committed to adhering to the Global Code when conducting its activities in the FX market. A Statement of Commitment signed on behalf of the Bank has been lodged on the ACI/AFMA public register. Furthermore, we have told each of the institutions on our counterparty panel that our trading relationship with them will cease at the end of this month unless they have provided us with a signed Statement of Commitment. Globally, other central banks are taking the same approach.

Maintaining the Code

As the market continues to evolve, it will be important that the guidance provided by the Code remains relevant. To ensure that this is the case, the GFXC will undertake a comprehensive review of the Code at least once every three years. In between times, specific issues may arise that warrant revisions to particular parts of the Code. In considering these issues, the GFXC may decide it needs to consult with market participants.

The first such consultation occurred last year when the GFXC sought public feedback on 'last look' practices in the FX market. As you are all doubtless aware, last look refers to a price maker having a final opportunity to accept or reject a trade request made on its quoted price.

In Principle 17, the Code had already set out guidance on what last look was, and how it could be used fairly as a mechanism to control risk. A key part of that guidance was ensuring that there was sufficient transparency from price makers about what they were doing.

While there will no doubt always be differing opinions on the merits of last look, there was one aspect of the practice that generated particularly intense debate when the Code was being drafted. This was whether it was legitimate for a price maker to undertake hedging, or other trading activity, during the last look window. That is, whether the price maker could transact in the market in response to the client's trade request before they have decided whether the request will be accepted or rejected. The concern was that if the client's request was ultimately rejected, information about their intentions would have already leaked into the market, leaving them in a worse position. Further, if the dealer trades in such a circumstance, they may be profiting from their knowledge of the client's intentions.

The GFXC's consultation on this issue attracted submissions from a wide range of market participants and industry associations. This included banks and others on the sell side who make use of last look, many from the buy side, as well as platforms and other technology providers. The submissions are all available on the GFXC's website. [\[6\]](#)

As expected, a variety of opinions were expressed in the submissions. Most respondents thought that trading during the last look window was inconsistent with good market practice. However, others argued that such trading allowed for tighter pricing and better liquidity provision for clients.

In the end, the GFXC's conclusion was that the Code's language needed to be strengthened to say that market participants should not undertake trading activity during the last look window unless there is an explicit understanding between the dealer and the client that: (a) the trade request will only be accepted if the dealer is first able to offset the risk in the market; and (b) all trading volumes that result from this activity in the last look window are fully passed on to the client. [\[7\]](#)

Arrangements that might meet this test are often referred to as 'cover and deal', where the dealer performs a role that is very similar to that of an agent. Of course, in a formal agency arrangement, there will be a very clear understanding between the parties, with certain obligations imposed on the agent. For those utilising 'cover and deal' arrangements, the Code is seeking to ensure that a similar level of understanding exists between the dealer and their client, one that acknowledges the risks associated with information leakage and precludes the possibility of the dealer profiting from that information by trading in the window and subsequently rejecting the client's trade request. Following its consultation on last look, the GFXC has formed a working group to investigate in more detail the usage and prevalence of 'cover and deal' trading arrangements in the FX market.

Absent such an arrangement, market participants should not be conducting trading activity in the last look window. The Code now also makes it clear that 'trading activity' should be understood to encompass pricing activity as well.

This is not to say that price makers can't otherwise continue to trade or update their prices during the last look window. However, they should not be allowing any information from the client's trade request to influence their trading activity or their price setting during that time. To underline that distinction, some additional examples relating to Principle 17 have been appended to the Code: one that shows how a market maker can continue to update their prices during the last look window in a legitimate manner, and one that illustrates inappropriate usage of the information from a client's trade request to update prices.

The GFXC's guidance on last look highlights the importance of price makers being transparent about their trading practices. It also recognises that we cannot solely rely on transparency to safeguard market integrity. Some have argued that so long as price makers are transparent about their practices, clients will be able to make informed choices, lessening the need for industry-level guidance. In the area of last look, the GFXC did not fully accept this argument. To protect the integrity of the market, it's not enough that the dealer simply discloses what they are doing; the disclosed arrangement must provide for all trading activity in the last look window to be passed on to the client.

There are other areas of market practice where the Global Code is clear that transparency on its own is not sufficient. Principle 11, for example, provides guidance on 'pre-hedging' – the management of risk associated with anticipated orders. While an important part of this guidance is that market participants should communicate their pre-hedging practices to their clients, the principle goes further by also saying something about how pre-hedging should be undertaken; namely, with due regard to prevailing market conditions and designed to benefit the client.

There is another, equally important, limitation with transparency that goes beyond the specific issues of trading in the last look window and pre-hedging the risks associated with anticipated orders. And that is how clients can actually obtain an adequate understanding of their counterpart's trading practices.

Banks, along with certain other liquidity providers, publish disclosure statements and, under the impetus of the Code, these statements now generally have much more detail than before. While this is undoubtedly a good thing, how confident can we be about the effectiveness of this approach? As many respondents to the GFXC's consultation on last look pointed out, in much of the trading on electronic platforms, the intermediation of a prime broker can mean that the client does not know the identity of the liquidity provider. Whose responsibility is it to provide the necessary disclosures in those instances and how can it be done?

The GFXC is very conscious of this issue and the implications it has for the transparency of the market. A separate working group on disclosures has been formed to consider the way forward.

Finally, the GFXC has also established a working group to draft additional examples on Principle 11 that could be added to the Code. Specifically, that group is tasked with providing examples of inappropriate pre-hedging practices.

Conclusion

I hope that gives you some flavour of what the GFXC is working on and how important it is to have a global body with both private and public sector representation seeking to establish principles of good practice. The working groups, along with the earlier consultation on last look, illustrate a commitment from the GFXC to ensure that the Code is a 'living document' and that it will keep pace with an evolving market.

To date, the signs are very promising that the Code is becoming embedded within the industry and I would encourage you all to be part of that. The widespread adoption of a Global Code will be of benefit to everyone in the industry, regardless of which side of the market they are on. Thank you for your attention, and I am happy to take a couple of questions if you have them.

Endnotes

- [1] The Code is available at <https://www.globalfxc.org/docs/fx_global.pdf>.
- [2] The current members of the AFXC are listed here: <<http://afxrba.gov.au/members/>>.
- [3] See ASIC (2017), 'Report 525 Promoting better behaviour: Spot FX', Final Report, May.
- [4] The details of the survey are available at <https://www.globalfxc.org/docs/gfxc_survey_results_dec17.pdf>.
- [5] The ACI/AFMA register is located at <<https://fxglobalcoderegister.afma.com.au/>> and contains the Reserve Bank of Australia's Statement of Commitment.
- [6] See <https://www.globalfxc.org/docs/gfxc_last_look_request_for_feedback.pdf>.

[7] The GFXC's response to the consultation is available at
<https://www.globalfxc.org/docs/gfxc_response_paper_dec17.pdf>.

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