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To the Fair and Effective Markets Review Team

We are glad to have the opportunity to contribute our views to the fair and effective markets review ('FEMR'). ICAP is well placed to respond, as we operate electronic venues and broking facilities as well as post-trade and information services across a wide range of FICC market segment and geographies.

The FEMR seeks to enhance the confidence in the UK and London as a place to invest and do business particularly in the wake of the Libor and FX cases. In so doing we should be clear on the ills we are trying to address, and how to intercept future concerns before they become full-blown scandals where the only regulatory "success" is enforcement some years later. The collective aim of regulators and market participants should be to imbue the financial markets with confidence and resilience so that they can perform their social and economic functions.

An important part of doing so is encouraging deeply liquid financial markets, able to survive shocks, support end users' hedging needs and facilitating the flow of capital and collateral throughout the financial system. Current and proposed regulatory and market pressures, through higher capital, collateral and transparency requirements, constrain firms from advancing credit and risk driving financial institutions out of market segments: particularly given the continual challenges in major economies. Without adequate liquidity and credit, there is a greater risk of volatility, mispricing and greater potential for abusive behaviour. It is in our view crucial that any review into the effectiveness of wholesale markets has regard to, and supports, the central function played by liquidity and liquidity providers in these broad and diverse markets.

We would also like to highlight a few other general issues that are crucial to fair and effective markets. They are fleshed out in more detail in response to specific questions, but we feel they are of wider relevance to wholesale markets:

- Confidence in FICC markets will only truly be 'repaired' if there is collective mechanism to agree a unified approach to the complexities of the FICC space – imposing standardisation on a diverse and complex market will not achieve the desired outcomes and could instead lead to market disruption. There should be a "no surprises" means for regulators and the industry to address developments when they arise, rather than letting them evolve in ambiguity and result in structural weaknesses and abuse by exploitation of those defects (the LIBOR example is all too salutary).

- Market participants should be given clear direction by regulators as to what is appropriate and not-appropriate in the reformed trading environment, which should be in collaboration with the industry: at present and in the light of fear of enforcement, we see confusion and hesitation amongst well-intentioned participants, to their potential detriment and the potential detriment of their clients. The aim of regulation should be to inspire confidence rather than sow doubt.

- Market operators and service providers like ICAP, can and do create systems to mitigate risk and increase standardisation in the still un-codified yet very much correlated FICC markets. Certain principles can be applied universally but we have to acknowledge that the FICC markets remain as complex and diverse as their real economy drivers, and make solutions appropriately specific. Neither should regulation be so proscriptive that technology developments aimed at identifying and mitigating risk are stifled.

- Accuracy and empiricism in valuation; failure to robustly value financial transactions has (rightly) led to increased focus on everything from benchmarks to High Frequency Trading (HFT). There should be clear guidance for firms to support their internal decision making, so that the basis for their valuations is clear (albeit necessarily a mix of quantitative and qualitative components). An example would be data points and judgements that lead to a Libor submission. The most obvious defect in LIBOR and other opinion-based benchmarks was the seeming absence of empirical data or explicit factors to support submitters' views. There are a variety of practical steps we could all take, including greater focus on internal trade position and verification processes. This will be helped by automated operational and surveillance systems, and clarity of policy and process.

Finally, ICAP believes that whatever the FEMR recommends should not be so burdensome that it merely increases the cost and risk of doing business in London. Otherwise, the door for regulatory arbitrage remains open and businesses will simply continue their practices in other markets or less regulated venues. Instead the review offers an important opportunity to be forward looking and inspire confidence in the financial system.

In the Annex, we have answered the specific questions most relevant from an ICAP perspective in more detail. We hope you find them helpful and remain at your disposal to discuss any of the themes raised.

Yours faithfully

Duncan Wales

ICAP Group General Counsel

Annex

What does ‘Fair and Effective’ mean for FICC markets?

Q1: The Review would welcome respondents’ views on the definition of ‘fair and effective’ FICC markets proposed in Section 3. Does it strike the right balance between safeguarding the interests of end-users without unnecessarily impeding the effectiveness of FICC markets?

Are the concepts of transparency, openness and equality of opportunity appropriately specified? And how does the definition compare with those used in other markets, jurisdictions, organisations or legislation?

A key issue underlying the effectiveness of a market is liquidity. A well-functioning market must be underpinned by sufficient liquidity for there to be consistent observable prices, narrow spreads, and the ability to execute transactions or a series of transactions or strategies in the most liquid segments. Certain transaction types have periodic and intermittent liquidity. Those less liquid markets benefit from transparency only to a point. There is therefore arguably a greater need for increased chances of execution than mandated pre-trade transparency, provided that users of the market are treated fairly and valuations are supported empirically.

Current and proposed regulatory and market pressures, through higher capital, collateral and transparency requirements, constrain firms from advancing credit and risk driving financial institutions out of market segments thus harming the available liquidity to all market users. Without adequate liquidity and credit, there is a greater risk of volatility, mispricing and greater potential for abusive behaviour. It is in our view crucial that any review into the effectiveness of wholesale markets has regard to, and supports, the central function played by liquidity and liquidity providers in these broad and diverse markets to support user requirements.

In this context, the concepts of effectiveness and universal treatment may not always align perfectly. An example would be market making incentive schemes, and other arrangements with market participants, in which market participants are encouraged to provide liquidity not only through incentives, but also through trading arrangements. Whilst this could be deemed unfair, it can underpin the effective functioning of the market by increasing its consistency and resilience.

Another component underpinning the effectiveness and fairness of markets is competitiveness and openness. In order to achieve this, markets need to enable participants to choose which infrastructure provider to use rather than being coerced into choice by a lack of alternatives. We believe that the principle of open access to infrastructures (as set out in MiFID II), interoperability where appropriate and clarity on the component elements and/or factors that affect pricing, should feature prominently in any attempt to improve the fairness and effectiveness of FICC markets.

Finally, any attempt to comprehensively define fairness and effectiveness for the FICC markets, needs to take account of the diverse nature of these markets and the need for any proposed solutions to be tailor-made to the segment in question. Therefore, simply calling for transparency and standardised in the absence of evaluating the real economy drivers behind the diversity of instrument could end up compromising fairness, empiricism and reasonable judgement.

A framework for evaluating fairness and effectiveness

Q2: Of the six themes identified in Table A on page 5 (market microstructure; competition and market discipline; benchmarks; standards of market practice; responsibilities and incentives; and surveillance and penalties), which do you consider to be the most important factors contributing to the recent series of FICC market abuses? In which other

areas do you believe the fairness and effectiveness of FICC markets globally may be deficient? Do these answers vary across jurisdictions, or specific markets within FICC?

Are there any other important areas of vulnerability that are not identified in the table?

It is important to recognise that the financial crisis had its origin in mispricing of risk and over extension of credit. It was in this environment that excessive risk taking and the risks of overzealous or even abusive behaviour were magnified. Coupled with overexpansion and sometimes aggressive over-confidence in the banking sector, this sometimes sadly led to inconsistency and misconduct.

We therefore believe that significant contributors to the shortcomings we observed were weaknesses in market microstructure, and failures of institutions to have clarity on incentives and clarity in valuation.

We have to be clear sighted on the origins of risk and failure which almost invariably have a human and/or political origin, and design controls incentives appropriately. The recent failings are testament to this: both in the case of LIBOR and the FX fix, profits and losses were based on either future predictions submitted by banks whilst the prop teams of the same institutions were in possession of inside information as to the direction of their customer orders.

Whilst conflicts of interest between research, broking and primary and secondary markets in the equities space have long been well understood, in non-equities markets, these conflicts were much less well understood leading to a failure (or even the absence) of controls in key areas.

Barrier and digital options

Q3: Do trading practices involving barrier or digital options pose risks to the fairness and effectiveness of one or more FICC markets? How hard is it to distinguish between hedging and 'defending' such options in practice? Should further measures be taken to deal with the risks posed by barrier options, whether through market-wide disclosure of significant barrier positions, an extension of regulation or some other route?

The case of barrier and digital options are prime examples for areas where market conduct is currently questioned in the absence of having any specific guidance what would be considered appropriate behaviour.

Similar to the issue of trading around the fix, there is a real question how market participants can provide evidence that their trading intentions are genuine (whether on their own book or to carry out client orders) or whether they are trading for the sole purpose of creating distorted market prices that would benefit their own trading positions. We have observed genuine uncertainty on the part of market participants whether they could or should trade in certain instruments at certain times for risk of being perceived to be manipulating the market.

From a market infrastructure perspective these problems are very difficult to monitor or control. Is it possible to take a view whether an incoming order is aimed at manipulating the market or whether there is genuine interest in trading in or out of a specific position? Transparency may provide the answer but it could also jeopardise liquidity and reduce the ability of market participants with genuine hedging needs from using these instruments. Creating a subtle "thought crime" where real trading is involved is fraught with practical and logical difficulty in a free market.

Market microstructure

Q4: Does the market microstructure of specific FICC markets — including trading structures, transparency, asset heterogeneity or market access — enhance or diminish fairness and effectiveness? Where there are deficiencies, will recent or in-train regulatory

or technological changes improve the situation, or are further steps needed? How do these answers vary across jurisdictions, or specific markets within FICC?

There are clear areas for improvements across FICC markets as outlined above; in particular in the areas of valuation, transparency of valuation mechanisms, and managing conflicts of interest. It is important to understand that transparency in itself is not the solution. As we highlighted in response to question 1, transparency by itself, and without due consideration to the underlying market, can lead to loss of liquidity and less effective markets.

Finally, it is important that any perceived shortcoming are dealt with proportionality and with a view to changing circumstances. In the past, hard wired regulatory requirements did not stop LIBOR from becoming 'LIBID' which created significant distortions in incentives for sellers; nor did it stop the growth in the various ways LIBOR was used despite the evolution itself being observable both by market participants and public authorities. Similarly, FX markets were not adequately equipped to control the abusive usage of customer information.

It is thus crucial that regulatory responses are sensitive to evolution and not a static set of rules.

In fixed income:

Q5: Is greater use of electronic trading venues for a wider range of market participants possible or desirable? Are there barriers preventing a shift to a more transparent market structure?

ICAP is a long-time advocate of increased transparency, the move of liquid instruments to electronic venues and a greater emphasis on both pre and post-trade transparency; however, any decisions must not act to reduce liquidity in the marketplace – this would run counter to the aims of improving market trading.

There is therefore a delicate balance to be struck between encouraging and enhancing transparency on the one hand and retaining sufficiently liquidity on the other.

Q6: Is standardisation of corporate bond issuance possible or desirable? Should standardisation be contemplated across a broader range of fixed income products? How could that be brought about?

Corporate bond issuance and the design of corporate bonds is driven by issuer choice. Imposing standardisation could thus negatively affect the desired funding structure of corporate end users.

Q7: Should the new issue process for bonds be made more transparent through the use of auction mechanisms, publication of allocations or some other route?

In foreign exchange:

Q8: Are there risks associated with internalisation and last look practices? Are there barriers preventing increased pre and post-trade transparency in foreign exchange markets?

Last-look, in a fast changing market, is a necessary process to ensure that the credit position of a counterparty is verified before that party's market order is filled, thereby creating a new risk exposure between the price-maker and price-taker. Price-makers also use this process to ensure that the market has not moved materially against them in the time since the price was originally made.

It is recognised that the practical implication of these two requirements is that, since the credit check may, in some cases, given distance and speed of technology, take several hundred milliseconds, a price-maker could hold a price-taker's order for a material period during which the market may move in favour of or against the maker. A maker may then reject the order based on a final check on price movement. This risks allowing a market maker to be selective in accepting or rejecting a taker's order, even as the market is moving and while the taker is unaware if they will be filled or rejected.

On the other hand, the practice of last-look check on the market (and not just credit) allows the maker to offer tighter, riskier pricing, aware that a last-look will protect against adverse short-term movements.

In ICAP's view, while it is desirable to encourage price-makers to provide their acceptance/rejection with the minimum of delay, it is difficult to provide absolute values on a reasonable delay (for the reasons mentioned above). Therefore, market operators should seek to support price-makers and price-takers by both reducing time to process orders and also by providing a meaningful reporting on the fill rates and time taken to process orders by price-makers. The market participants will then be able to determine and reward better practice.

Q9: Are there barriers impeding the development of more comprehensive netting and execution facilities for transacting foreign exchange fix orders?

We are not currently aware of significant barriers impeding the development of netting and execution facilities. Innovation is already under way in this area and we welcome solution that will result from competition in this area. It is key that netting and execution facilities are independent of undue influence and offer improved auditing, transparency, STP, and electronic capabilities.

In commodities:

Q10: Are there any material barriers preventing greater transparency in OTC commodity derivatives markets? If so, what could be done to remove them?

Commodity markets are already under significant scrutiny as transparency requirements apply to EU markets and market participants either as a consequence of REMIT (for physically settled power and gas contracts) or MiFID II which captures most remaining commodity trading and imposes strict pre- and post-trade transparency requirements. A much greater risk is the effect that EU regulations are having on the preparedness of market makers to support liquidity and price formation in these markets leading to a widening of the bid-offer spread, and ultimately higher end user prices.

We have also witnessed banks withdrawing from commodity markets, driving commodity trading away from regulated EU markets into more opaque markets.

This was highlighted in FCA's commodity markets update from February 2014[1], which notes that "there has been a general theme of non-bank entities taking a more prominent role at the expense of banks". And Switzerland has now become a key market for commodity trading in the absence of applying the same scrutiny as EU markets – as highlight in the FCA paper which noted "that Switzerland has 35% of global crude oil trading and 60% of global metals trading, a market share that reflects the trading companies domiciled there rather than the size of the underlying Swiss economy."

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[1] http://www.fca.org.uk/static/documents/commodity-market-update-1402.pdf

Any move to force more price transparency could result in even less on-shore trading activity and significantly increase the price and trading spreads for end users.

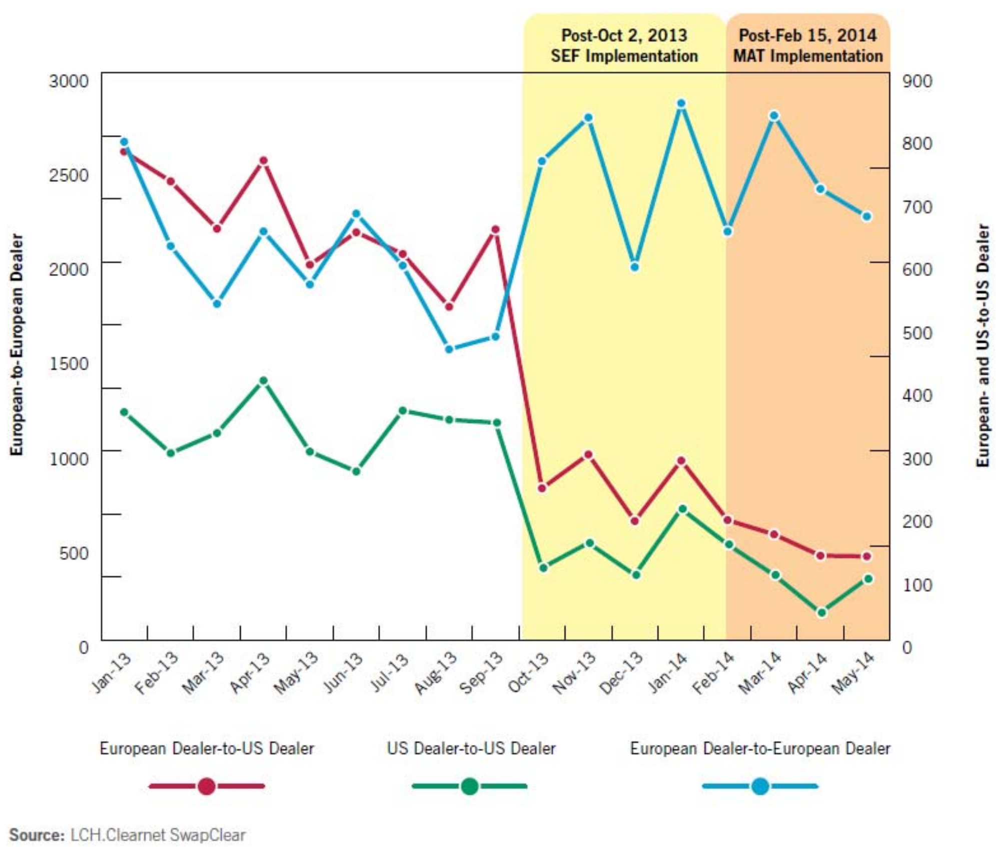
Besides the focus on price transparency, the fair and effective markets review should also consider the effect of reduced counterparty transparency in the commodity markets. With the advent of on-exchange trading, there has been a much reduced ability to de-mask the counterparty before confirming a trade. This means that it is now much more difficult to identify, from a market perspective, whether a dominant player is creating a short squeeze. In the absence of counterparty transparency, it is left to the regulator to control this kind of abusive behaviour without any way for the market to exercise self-control.

Regulatory measures:

Q11: Are there any areas of FICC markets where regulatory measures or internationally co-ordinated regulatory action are necessary to address fundamental structural problems that exist?

We have observed serious fragmentation in swaps markets in light of different timelines and different implementation methods adopted by different regulatory authorities. On the back of the Dodd-Frank Act in the US, and the lack of deference to non-US regimes for the supervision of venues and participants, the trade flow between US-based market participants and others has virtually ground to a halt.

This is exemplified in the following chart:



It is of crucial importance that, on a global basis, regulatory authorities reconsider how to regulate what are essentially global markets and avoid liquidity fragmentation which can result in less effective, and potentially less fair, markets.

Conflicts of interest and information flows

Q12: Where do potential conflicts of interest arise in the various FICC markets, and how do they affect the use and potential abuse of confidential information, both within and between firms?

Banks acting in FICC markets, and financial markets more general, are certainly some time competitors. However, in many areas they are also collaborators – whether in debt underwriting, syndicated lending, settlements, or operating ATMs.

There is little clarity around what information could and should be shared, and where sharing of information can lead to possible conflicts of interest and provide the basis of manipulative behaviour. This is the kind of issue where industry and public authorities should issue clear guidance; ideally in a collaborative manner ahead of issuing specific warnings. Enforcement should obviously be used where such warnings are ignored or flouted.

Q13: How can the vulnerabilities posed by such conflicts be reduced? Are existing internal structures and control procedures sufficient? Where they are not, are further internal management controls required (such as better trading floor design and/or closer monitoring of electronic communications within and between firms) or is more radical action required to remove conflicts altogether?

Competition and market discipline

Q14: Is there a relationship between the level of competition in FICC markets globally and the fairness and effectiveness of those markets? What risks are posed by the increase in concentration seen in some FICC markets? In answering this, please have regard to the geographical scope of any relevant markets.

A key component for the effectiveness and fairness of FICC markets is competition at all levels of the trading chain, from execution through to clearing and settlement. To enable competition, ICAP has always been a keen advocate of open access to infrastructure providers as it allows market participants to choose where they trade and clear transactions, rather than being forced to use a captive infrastructure provider.

Today, we see a split in the competitiveness of derivative markets, which needs to be addressed, between futures platforms which allow little competition and act as de facto monopolies, and off exchange venue trading which is greatly competitive, results in multiple competing venues offering liquidity, and regularly results in open interest moving from one platform to another.

The status quo in the futures world is one where products are concentrated in one venue with little trading outside it and no ability for banks to internalise trading. The concentration of these futures markets in the EU was publicly highlighted by the refusal of European competition authorities to give the Deutsche Boerse – NYSE.Euronext merger the go-ahead.

The existing structures gives exchanges a free hand to set fees and extract undue profits from the market. And these different dynamics are also reflected in fee structures – whilst there has been constant pressure on fees in the off-exchange markets, this has not always been reflected in the exchange space. We are clear that opening access and allowing competition is the best way to deliver improvement for market participants and achieve more efficient pricing of contracts.

In this regard, we should bear in mind that whilst markets are often global in nature, the authorities' response is regional by design and a balanced approach to avoid fragmentation of markets is required.

Promoting effective competition through market forces

Q15: To the extent that competition is currently ineffective in any of the FICC markets, are there market-led initiatives, technological or structural changes that may remedy this situation?

A possible initiator for changes in this area is the advent of the European MiFID II legislation. Whilst its reach is limited to the European Union, it could start a process of instilling much needed competition in certain market segments.

Q16: Are there any lessons that can be drawn from experiences in other financial markets (or indeed other markets) about the ways that alternative or evolving market structures could impact on competition in FICC markets?

There are various examples: In Europe, the advent of competition at the trading and clearing level for equities (as well as interoperability between core infrastructure providers) has led to a significant reduction in fees, both for trading and clearing purposes.

In the US, the single stock option market – which is currently cleared through a single CCP – is split between a number of trading venues which compete on price and service benefitting the end consumer.

These are prime examples of competition driving effective and fair markets through offering choice for market participants.

Q17: How effective is market discipline in enforcing sound market practices in each of the key FICC markets? What could be done to strengthen it?

Market discipline will only be achieved through creating appropriate standards in the relevant micro-structure.

Promoting effective competition through regulatory and legislative initiatives

Q18: In what ways might competition in any of the key FICC markets usefully be addressed by competition authorities (eg by assessing the state of competition in relevant markets)?

Q19: Are there any additional regulatory reforms that could be helpful in promoting competition and market discipline in FICC markets?

We believe that before designing any further regulatory initiatives, the current regulatory reform agenda being implemented or proposed should take full effect first. With the complexity and various interdependencies created among regulations, it is difficult to gauge the total impact, and the creation of potential undue systemic risk.

Regulators should therefore focus on synchronizing implementation timelines and greater regulatory convergence in general – both European and global – in order to avoid regulatory arbitrage and potential unfair competition, as mentioned in Q11.

Q20: Is there a need for better awareness and understanding of the existing competition framework among FICC market participants, both at firm and individual level? How do you think that might be best achieved?

Benchmarks

Q21: Do current domestic and international initiatives by industry and regulators to improve the robustness of benchmarks go far enough, or are further measures required?

Current and upcoming regulation is likely to change the landscape of benchmark administration, submission and usage. A major concern is the lack of harmonisation between different jurisdictions. Whilst the UK position on benchmark regulation as undertaken by HMT is broadly aligned with IOSCO principles, there are risks that the costs of being a benchmark administrator or submitter become prohibitive, endangering the production of the benchmark itself. This concerns is also alive in a European context where some member states are in favour of a broader regime, which may have repercussions on third country users and administrators and particularly in relation to recognition of third country regimes.

To avoid prohibitive costs and risk to the benchmark administration, a proportionate approach is key. It is therefore necessary and appropriate to differentiate between transactions-based benchmarks (which don't have to abide by the same suite of requirements) and estimate-based benchmarks (like LIBOR).

Please find attached our response to the FEMR benchmarks consultation as submitted on 23 October 2014.

Industry-level measures

Q22: What steps could be taken to reduce the reliance of asset managers and other investors on benchmarks?

Q23: What additional changes could be made to the design, construction and governance of benchmarks?

Beyond the regulatory framework for benchmarks, we would also like to comment on provision of execution against benchmarks. ICAP's EBS service provides, amongst others, a matching service around FIX. We believe that the rules and practices in the operation of any matching service should be transparent and fully understood and accepted by all participants and those indirectly serviced by such an operation.

This is because we believe that the risks associated with FIX matching, and the filling of mismatched orders, should be fully understood by the underlying organisation (typically asset managers and some corporations) seeking the fill at the benchmark. This transparency will enable the underlying party and the dealer offering a benchmark fill service to share a common understanding of the overage risk and the need either that the overage and associated slippage should pass back to the underlying party of that the underlying party must pay a clear premium to insure the provider against the risk of being left with an overage.

Such transparency of the operation of the matching mechanism and risks of overages should mitigate against the risk and opportunities of either type of party being pressured to game the process.

Q24: Should there be an industry panel to discuss benchmark use and design with the aim of assisting industry transition?

Regulatory action

Q25: What further measures are necessary to ensure full compliance with the IOSCO Principles for financial benchmarks by all benchmark providers?

Q26: How can the regulatory framework provide protection to market participants for benchmarks administered in other jurisdictions in a proportionate way?

It is clear that there are significant costs associated with a regulated regime, especially around system and control requirements, and these may lead to a number of benchmark providers exiting the market or relocating to third countries.

To ensure a level playing field, transparency around the administration of benchmarks is key and we would highlight the need for benchmark administrators (irrespective of location) to have standard licensing policies, including any rights and obligations. The precise nature of licensing terms will depend on the individual benchmark but there should be transparent and consistent pricing guides for benchmark products and we would encourage a requirement on administrators to publically publish fee structure schedules to ensure transparency.

Standards of market practice

Q27: Are existing sources of information regarding standards of market practice across FICC markets globally: (a) already sufficiently clear (or will be once current regulatory reform has concluded); (b) sufficient, but in need of clearer communication or education efforts; or (c) not sufficiently clear, requiring more specific guidance or rules to provide more detail or close genuine gaps?

Q28: Box 7 on pages 36–37 discusses a number of uncertainties over FICC market practices reported by market participants, including: the need for greater clarity over when a firm is acting in a principal or an agency capacity; reported difficulties distinguishing between legitimate trading activity and inappropriate front-running or market manipulation; and standards for internal and external communication of market activity. To the extent that there are uncertainties among participants in the different FICC markets over how they should apply existing market standards in less clear-cut situations, what are they?

It is increasingly important for public authorities to set out their stance on what they perceive to be good and bad behaviour in a trading context. In an illiquid market or when dealing in large sizes, a dealer is likely to be told upfront by a client that a large order is coming his way - the dealer needs to ascertain through price discovery where bids and offers stand in the market to ensure they are pricing the trade at a fair level. There is increasing uncertainty amongst the dealer community when it would be appropriate to embark on price discovery for fear of being seen as deliberately moving the price. It is therefore important that regulatory guidance is precise in defining when a dealer can undertake price discovery (e.g. 30mins before the order).

In the absence of clarity, this could result in worse prices for end users or even an unwillingness on the part of the dealer to participate in the pricing altogether.

As an intermediary we have observed how dealers are increasingly unsure what they can and can't do in these circumstances. Regulatory guidance (what we would call a 'no surprises approach' to conduct norms) would be extremely helpful. To arrive at that point, a more collaborative approach between regulators and regulatees (ie you don't get punished by being open about the way you currently conduct your business and asking for clarification whether certain conduct meets the spirit of the regulation) is necessary.

Q29: How could any perceived need to reduce uncertainties best be addressed: (a) better education about existing standards; (b) new or more detailed market codes on practices or appropriate controls; or (c) new or more detailed regulatory requirements?

Will these uncertainties be dealt with by current reforms?

Q30: How can the industry, firms and regulators improve the understanding of existing codes and regulations by FICC market participants and their managers?

Q31: Should there be professional qualifications for individuals operating in FICC markets? Are there lessons to learn from other jurisdictions — for example, the Financial Industry Regulatory Authority's General Securities Representative (or 'Series 7') exam?

Can the industry help to establish better standards of market practice?

Q32: What role can market codes of practice play in establishing, or reinforcing existing, standards of acceptable market conduct across international FICC markets?

A code of market conduct can only work effectively if it engages market participants whilst having clear expectations around the behaviour and conduct it is looking to preserve and foster from interaction with public authorities. In the absence of having clear guidance and a 'no-surprises' approach to regulation, any code would fail to provide the necessary deterrent for breaches of its provisions.

Whilst a market code of conduct should be all-encompassing in scope by capturing various FICC market segments, it should also be flexible enough to be relevant to the complexities of these different segments. This would ensure it can adapt to changes in market practise and be proactive in identifying market trends. Such a code could be overseen by market practitioners whilst involving public authorities to keep them abreast of observed market behaviours, as successfully applied in the operation of the UK's existing Takeover and Corporate Codes.

As noted above, the key benefits of operating a market practice code supported by an industry body, would be a more reliable solution to ensure it can adopt to innovation and changes in market structure – a key aspect that would be lacking in a purely regulatory solution to market conduct.

Q33: How would any code tackle the design issues discussed in Section 5.4.3, ie: how to ensure it can be made sustainable given industry innovation over time? How to

differentiate it from existing codes? How to give it teeth (in particular through endorsement by regulatory authorities or an international standard setting body)? How to communicate it to trading teams? Whether, and how, to customise it for individual asset classes?

Should the scope of regulation be extended?

Q34: In the context of implementing MiFID 2, which of the FCA Principles for Businesses should apply in relation to MiFID business with Eligible Counterparties?

Q35: Are there any financial instruments that should be brought more fully into the scope of regulation in order to improve the fairness and effectiveness of specific FICC markets? For any instruments proposed: (a) what protections does the current framework provide; (b) what gaps remain of relevance to fairness and effectiveness; and (c) what is the cost/benefit case, bearing in mind the Review's Terms of Reference as set out in Section 1?

The regulatory parameter currently encapsulates a wide variety of products and the advent of MiFID II will result in a further increase by capturing a range of additional commodity and foreign exchange products in its scope.

It is worth noting that, even in the absence of a given product being captured within the regulatory perimeter, the firms trading and selling these products are fully regulated and abide by strict conduct standards.

In the context of gas and power contracts, we would also like to highlight that – even though they are nominally outside the financially regulated space – they are nonetheless subject to strict market abuse and transparency requirements under REMIT.

Responsibilities, governance and incentives

Q36: How much of a role did inadequate governance, accountability and incentive arrangements play in the recent FICC market abuses, and to what extent do these remain potential vulnerabilities in FICC markets globally?

In addition to on-going regulatory changes, what further steps can firms take to embed good conduct standards in their internal processes and governance frameworks? And how can the authorities, either internationally or domestically, help to reinforce that process, whether through articulating or incentivising good practice, or through further regulatory steps?

Firm-wide initiatives to improve incentives and governance

Q37: Do respondents' agree that the thematic areas highlighted in Section 5.5 are key priorities for FICC firms (fine-tuning performance measures; adjustments to remuneration; attitudes towards hiring, promotion and advancement; closer board involvement in governance of FICC activities; and clearer front line responsibilities)?

What specific solutions to these challenges have worked well, or could work well? And how best can the authorities help to support these initiatives?

Market wide initiatives to align market conduct, incentives and governance

Q38: To what extent could the Banking Standards Review Council help FICC market participants to raise standards collectively — in particular, are there other steps that could be taken to help complement or extend this initiative in FICC markets for non-banks and internationally?

Regulatory initiatives to improve governance and incentives

Q39: Are there other regulatory measures the authorities could take to strengthen personal accountability or otherwise improve the way firms manage incentives and governance? In particular, should any or all of the measures in the Senior Managers and Certification regime be extended to non-bank firms active in FICC markets?

Surveillance and penalties

Q40: What role can more effective surveillance and penalties for wrongdoing play in improving the fairness and effectiveness of FICC markets globally? How can firms and the industry as a whole step up their efforts in this area?

And are there areas where regulatory supervision, surveillance or enforcement in FICC markets could be further strengthened?

Firm level surveillance

Q41: How can firms increase the effectiveness of their own surveillance efforts across FICC markets globally? What role could the industry play in helping to explore best practices on how to make whistleblowing and other similar regimes more effective? Is there scope to make greater use of large scale market data sets and electronic voice surveillance to help detect cases of abuse in FICC markets? Are there other potentially effective tools?

From a market infrastructure provider's perspective, surveillance has to encompass two elements: a control function for internal compliance, and one focusing on participants' behaviour. At ICAP, we have addressed both forms through policies and rule books, of course, but also via targeted, third-party technology based methods monitoring both internal communications through the Global Relay system[2], and participants' transactions through the APAMA and other transaction monitoring systems[3].

Surveillance efforts in firms are currently undergoing significant changes, both as a consequence of regulatory demands (Market Abuse Regulation and MiFID II) and due to the increasing electronification of trading which requires updated and automated surveillance mechanisms. However, it is crucial that – as we have done – industry finds efficient technology based solutions to effectively monitor their activities.

The effectiveness of the surveillance depends on a number of factors but, for firms like ICAP that operate across different segments of the FICC markets, an understanding of the differences in market characteristics is crucial.

To support firm-wide surveillance efforts, it is important that there is alignment between reporting obligations and data to be collected from market participants.

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[2] http://www.globalrelay.com/

[3] http://www.softwareag.com/corporate/products/apama_webmethods/analytics/overview/default.asp

Firm level penalties

Q42: Are there processes or structures that can allow firms to punish malpractice by their own staff more effectively (for example, penalties for breaching internal guidelines)?

Q43: Could firms active in FICC markets do more to punish malpractice by other firms, for example by shifting business and reporting such behaviour to the authorities?

Following on from our observations above, one clear advantage of operating across markets and having adequate surveillance is the ability to identify unusual behaviour or potentially harmful market developments. To list but one example, individuals in some banking institutions were aware that the LIBOR process was ineffective. However there simply was not an adequate process in place to flag these concerns to a regulatory body that could definitively address the matter. Unlike the process put in place for the FCA suspicious transactions' (STR) regime, there is currently no equivalent process for firms to flag up structural issues, or specific concerns, in the FICC markets nor for regulators to react to them. And whilst the Bank of England's engagement as part of the fair and effective markets review is helpful, it would be beneficial to have a standing mechanism in place to deal with such issues going forward.

An institutional "whistleblowing" mechanism that allows regulated firms to feedback to public authorities on a protected basis in relation to behaviour or potential defects observed in the FICC markets would be likely to have effect.

Such a mechanism would enable public authorities to investigate market mechanisms and set out clearly their expectations for appropriate conduct. It would also better enable infrastructure providers to report participant behaviour without running the risk of damaging commercial relationships.

Crucially, such process should enable the FICC industry as a whole to engage in an effective self-diagnosis process; provided that public authorities allow such a process to operate efficiently and refrain from over-punishing those that make use of it.

Regulatory level surveillance and supervision

Q44: Is the current supervisory approach and level of intensity dedicated to supervising conduct within the UK wholesale FICC markets appropriate?

Q45: Are there ways to improve the data on FICC market trading behaviour available to the FCA, whether through the extension of the regulatory perimeter or otherwise?

Regulatory-level penalties

Q46: What further steps could regulators take to enhance the impact of enforcement action in FICC markets?

Having a clear understanding of the diverse nature of FICC markets and a mechanism enabling early identification of misconduct would assist regulatory authorities in setting out clearly regulatory expectations and guidance for the industry in the form of pre-emptive and thematic warnings – to a sufficient degree of clarity and detail to address potential problems effectively.

This would result in a regulatory enforcement approach grounded on a "no-surprises" basis which would instil greater confidence and certainty of action for market participants. The warnings about the dysfunction of Libor could have led to early diagnosis and preventative action, rather than the retrospective "regulation by enforcement" that in fact occurred, where regulators imposed (perfectly reasonable) criteria for evidencing the rationale behind Libor submissions many years after the event[4].

In this context, it should be clear what legal consequences can arise from misconduct (and the type of misconduct) based on publicly stated policy objectives setting out market conduct expectations. This would contrast with a current enforcement approach where specific market behaviour is retrospectively being scrutinised by, for example, anti-trust authorities – in the absence of any previous elaborations that certain activities may be viewed as anti-competitive.

Firms are now faced with multiple-jeopardy in respect of the same underlying events, with multiple regulators able to impose financial sanctions for the same misconduct. It would provide greater clarity to customers, investors and firms if regulators make clear which of them is responsible for what component of a firm's activity. This is particularly true for FICC markets, which are often international in nature. Enforcement must be coordinated cross-border to ensure than firms and investors have legal certainty as to the standards and legal system to which they are subject.

Q47: Should consideration be given to greater use of early intervention, for example, temporary suspension of permission for a particular trading activity for firms or individuals or increased capital charges?

Q48: Is there a need to widen and or strengthen criminal sanctions for misconduct in FICC markets?

The financial crisis has led to strengthening in the sanctions regime by public authorities and we have witnessed an increasing number of sanctions for misconduct in FICC markets. As highlighted earlier, the advent of a number of regulatory initiatives will further strengthen the market abuse regime and, at firm level, we are enhancing surveillance efforts as well.

We don't see the need at this stage to further strengthen the criminal sanctions regime in the UK, as there are adequate laws and mechanisms in place. Also, for the purpose of the FEMR I might borrow Foucault's expression that 'there is no glory in punishing' if there are better opportunities for prevention. The focus should be on corrective actions to alleviate harmful misconduct early rather than seeing high-profile sanctions as an end in itself. In particular, and unless a direct link can be established, sanctions should be imposed on the individual and not the firms. There should be a fairer balance of risk allocation between individuals and their employers; in the Libor cases of the last three or so years firms paid more than £4 billion in regulatory settlements – a burden ultimately paid by remaining employees, shareholders and tax payers - while only 13 individuals have yet been charged by the relevant agencies, and none brought to trial. This asymmetry implies that much of the conduct (though egregious) falls short of criminality.

It is therefore worth considering creating a code of conduct to which individuals within the financial services industry subscribe and a membership or accreditation they receive: it would then be much more effective to sanction individuals that have been found to be involved in misconduct by removing or suspending such a membership or accreditation, so that there is a higher risk for individuals and less emphasis on trophy settlements with firms that have no practical means of progressing through a full enforcement case in court or tribunal (due to the intolerable reputational and uncertainty risks).

[4] CFTC press release http://www.cftc.gov/PressRoom/PressReleases/pr6289-12

Q49: Is the approach set out in the Criminal Sanctions Market Abuse Directive appropriate for the United Kingdom? Are there additional instruments or activities to those envisaged by the Directive that should be covered by the domestic criminal regime?