

# An open letter from the Foreign Exchange Joint Standing Committee to participants in the London Foreign Exchange market

Dear Market Participant

28 May 2003

The Foreign Exchange Joint Standing Committee (FX JSC) is a market liaison group, jointly responsible for maintaining and updating the Non-Investment Products Code (NIPs Code), a statement of good market practice covering a variety of OTC products, including Foreign Exchange, Wholesale Deposits and Bullion. The FX JSC has responsibility for the sections in the Code pertaining to foreign exchange.

Banks have been concerned about the practice of undisclosed principal trading for some time. This is where a fund manager, acting as an agent, trades on behalf of a client – the principal to the transaction – with a counterparty, but does not reveal their identity to that counterparty. *If the investment firm trades in its own name, but on behalf a client for whom it is acting as agent, then this is not undisclosed trading.*

The failure to disclose their identity exposes the bank, and in some cases the fund manager to a number of risks. Firstly to credit risk in that banks are unable to assess the credit-worthiness of the undisclosed counterparty. Secondly to legal risk in that banks rely upon representations and warranties from the fund manager, pertaining to the undisclosed principal. There are also regulatory and reputational risks in that the bank may be unable to verify if it is complying with anti-money laundering regulations or not.

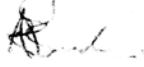
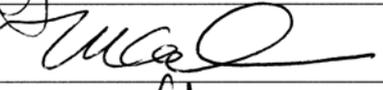
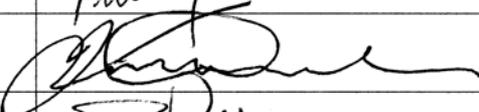
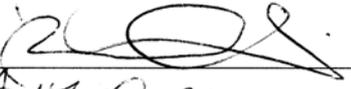
The Committee has undertaken extensive consultations with banks and fund managers, including the Investment Management Association, and recognises the commercial pressures that many fund managers are under to maintain client confidentiality. We have therefore agreed, with representatives from the banking and fund management community, a process whereby confidential information pertaining to the undisclosed principal – including the full legal name– should be disclosed, but only to the credit, legal or compliance areas of the counterparty. This information should only be used for risk assessment and management purposes and it must not be disclosed to the front office except in the case of default. The bank should have procedures in place to ensure that these confidentiality constraints are complied with. This process will be embodied in a revised version of the NIPs Code.

The Committee recognises that the practical implementation of this change cannot be achieved immediately. Therefore a **'grace' period of one year will apply before the revised provisions of the NIPs Code are deemed to be in force.** This will provide institutions with sufficient time to amend client legal agreements and to change IT systems. **This grace period will run until 31 May 2004.** The revised NIPs Code wording (as well as the original wording) is shown in the annex.

The Committee have also consulted with similar committees in other international centres, to ensure the practice is addressed at a global level. The New York Foreign Exchange Committee is taking steps to make a similar change in New York trading (see [www.newyorkfed.org/fxc/2002/fxc1106.pdf](http://www.newyorkfed.org/fxc/2002/fxc1106.pdf)). Similarly the ACI (the Financial Markets Association) has endorsed this work and is in the process of amending its own 'Model Code', which governs market practices in many countries, including the Republic of Ireland and Canada. The Committee welcomes the statements of support from these organisations, as well as from the Financial Services Authority, the Bank of England and other Central Banks and Market Practices committees abroad.

The FSA is a member of the Committee. Although the focus of this amendment is within non investment business, in determining whether a firm satisfies the Threshold Conditions for Authorisation in respect of conducting its business with integrity and in compliance with proper standards, the FSA has stated that it may take into account whether the firm has contravened relevant industry standards, including the NIPS Code (see COND 2.5.6).

The Committee believe that the steps it has taken will ensure that a source of unquantified credit risk for institutions transacting in the foreign exchange market will be removed. We, the undersigned members of the Foreign Exchange Joint Standing Committee, endorse the change to end the practice and request that your firm take steps to implement and follow the revised provisions.

Mark Allen	Royal Bank of Canada	
Mike Beales	Wholesale Market Brokers' Assoc.	
Marcus Browning	Merrill Lynch	Mark Browning
Adam Burke	JP Morgan	
Jim Cameron	Banco Popolare di Lodi	Jim Cameron
Alan Collins	Bank of America	Alan Collins
Darren Coote	UBS	
Jeff Feig	Citigroup	
Paul Fisher, Chair	Bank of England	Paul Fisher
Geoff Grant	Goldman Sachs	
David Hacon	Financial Services Authority	
John Herbert	Garban-Intercapital	John Herbert
Simon Hills	British Bankers' Association	Simon Hills
Jack Jeffery	EBS	
Michael Kahn	State Street	
Rob Loewy	HSBC Bank Plc	
Peter Murray	Morgan Stanley	
Peter Nielsen	Royal Bank of Scotland	
Ivan Ritossa	Barclays Capital	Ivan Ritossa
Jon Simmonds	Credit Agricole Indosuez	
Matt Spicer	CSFB	Matt Spicer
Gordon Wallace	Deutsche Bank AG	Gordon Wallace
Brian Welch	Association of Corporate Treasurers	Brian Welch

The Secretary of the Foreign Exchange Joint Standing Committee can be contacted on 020 7601 5976, or by email: [andrew.grice@bankofengland.co.uk](mailto:andrew.grice@bankofengland.co.uk). Copies of the NIPs Code are also available upon request.

## **Annex**

### **Revised wording for the NIPS code from 1 June 2003**

‘Participants in the wholesale market should not seek or accept transactions placed on behalf of clients whose existence or identity has not been disclosed. Trading on such a basis raises important conduct of business as well as prudential considerations particularly in terms of the counterparty’s ability to satisfy requirements relating to knowing the identity of their counterparty (e.g. FATF requirements) and assessing their credit risk to a particular counterparty. Where market anonymity is desired, fund managers may identify clients for which trades have been transacted by referring to code names, provided that the client’s actual identity to which the code relates has been communicated to the counterparty’s credit, legal or compliance function, who will not use the information other than for risk management purposes. Where codes are used, counterparties will not reveal any information provided by the fund manager pertaining to their clients outside the credit, legal and compliance functions, except in the event of default. Counterparties will have appropriate procedures in place to meet these obligations. In the case of wholesale deposits, where no credit risk is incurred by the deposit taker, there is no requirement for the fund manager to disclose the existence or the identity of the client, provided that the fund manager is subject to appropriate sections of the UK anti-Money Laundering regulations or their EU equivalent.’

### **Previous wording**

‘There has been a growing trend towards discretionary management companies dealing in wholesale market products on behalf of their clients. For its own commercial reasons a fund manager may not wish to divulge the name of its client(s) when concluding such deals. This practice raises important conduct of business as well as prudential considerations, particularly in terms of principals’ ability to know their counterparties and to assess their credit risk to those particular counterparties and to satisfy documentation requirements. Before any institution transacts business on this basis, its senior management should decide, as a matter of policy, whether they judge it appropriate to do so. In doing so, they should consider all the risks involved, and fully document the decision that they reach.

For FSA authorised firms, appendix 1 chapter LE of the Interim Prudential Sourcebook sets out rules as regards dealing with unidentified principals.’