Fair and Effective Markets Review
Bank of England
Threadneedle Street
London EC2R 8AH

30 January 2015

Dear Sirs,

How fair and effective are the fixed income, foreign exchange and commodities markets? Consultation paper

The Royal Bank of Scotland ("RBS") welcomes the opportunity to respond to the Fair and Effective Markets Review's ("FEMR") consultation paper.

As a major FICC-markets participant, RBS is well placed to provide feedback and has opted to answer a selection of the 49 questions posed in the consultation paper on those areas where RBS believes it has specific and relevant expertise to share, underpinned by market positioning and experience.

The following pages will address questions within each of the categories of the consultation paper. However RBS would like to highlight the following key macro points as over-arching comments on the developing shape of the FICC business:

- RBS is supportive of efforts to improve ethics and behaviour in FICC markets and believes that a global professional standards body would be an important initiative to this end.

- RBS believes that the practice of dealing at the fix requires challenge to bring it in-line with technological advances and the need for greater transparency. Assuming that benchmarks commute to a more observed pricing basis, RBS has recommended a number of improvements in this area, taking the WMR Fix as an example.

- Transparency and effectiveness are not equivalent - flow clients appreciate the price benefits that transparency offers whilst clients with one-off event-driven business will prefer effectiveness of execution not to be compromised through transparency to the wider market.

- Generally, RBS believes that markets function effectively. Inevitably large or unusual transactions will have a market impact, and we believe this impact can be incorrectly perceived as a structural weakness in the market.

- A key request of regulators and NCAs is to develop harmonised policies to increase consistency across regional boundaries. To this end RBS welcomes the increasing recognition of this, evidenced by the recent IOSCO Task Force on Cross-Border regulations.

- Recent regulatory change and a lack of global coordination have led to a significant number of market participants and market-makers leaving certain FICC product markets,

whilst the barriers to entry for new participants have increased. This has negatively impacted liquidity.

- The ability of banks to accommodate and fund changes to existing system architecture risks being over-estimated, in light of ever greater focus on allocation of and returns on capital. RBS recommends that the costs to banks of increased security and price transparency be included in the cost/benefit analyses that are conducted in conjunction with new regulations.

- Systemic risk still exists, but is being concentrated in new, regulatory-driven market structures such as Central Counterparties (CCPs), Multilateral Trading Facilities (MTFs) and Trade Repositories; it is arguable that the regulation actually creates systemic risk on these venues.

Our more detailed comments on a selection of questions in the consultation paper are contained within. Should you find it useful, we would be happy to elaborate further on any of the points made in our response.

Yours faithfully

Peter Nielsen

Global Head of Markets

By email to: FEMR@bankofengland.co.uk

Response to specific questions raised in How fair and effective are the fixed income, foreign exchange and commodities markets? Consultation document

Question 3: 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?

We would highlight that there is ambiguity around trigger events. The proliferation of trading venues and a lack of common dealing convention means that there can be disputes over whether a barrier has triggered or not. Any new regulation should consider this issue.

The legitimate and appropriate use of delta-hedging in respect of the option positions can have a favourable effect on the outcome of the option position which makes it very difficult to differentiate such legitimate hedging activity from behaviour which has been referred to as 'defending a barrier' in the CP. This can be mitigated through internal processes, via supervisory justification, but still remains relatively subjective and opaque.

In effect, hedging of any large option position, including but not limited to barriers, will likely have an effect on the underlying market. Consequently the internal processes and controls around this need to be clear. We believe good market practice is supervisory approval for barrier option lifecycle hedges in excess of an agreed level, but for information to be limited to the options trader and his supervisor. We believe that greater internal dissemination within the Front Office could contradict the proper limiting of information sharing internally.

Looking externally, RBS believes there would be merit in educating clients about the mechanics and the resulting price optics of hedging a barrier or digital option. We would however highlight again that where the underlying trade is beyond the market's normal size, hedging activity can drive market movement.

Summary

- The market needs an agreed definition of what constitutes a barrier trigger
- Banks have a responsibility to prudently manage their market risk, meaning they need to hedge their option positions
- However, hedging activity can generate a favourable outcome relative to the option positioning

Question 5: 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?

The significance of electronic trading has increased markedly over the last 10-years, pre-dating the financial crisis and the subsequent regulatory response. The utility value for

market participants in moving to e-commerce from the more traditional dealing practices has been tighter spreads, operational efficiency and initially more aggregated liquidity.

Further electronification is likely for products that currently enjoy very low rates of electronic trading, such as European corporate bonds. However this move needs to offer the improvements referred to above, and in order to be positive, development should retain features that will minimise the disruption that can be created by latency-minimisers. The pre and post-trade transparency requirements under MIFID II could partially address this, but will require market makers to review their 'commercial policy' in order to ensure that appropriate client differentiation is established, in terms of access to quotes. It also means that the MIFID II price broadcasting thresholds will need to be dynamic to reflect the current state of the market.

Where the degree of electronic trading is already high – FX for example – the OTC nature of the products suggests further development will likely only be driven by regulatory pressure or direction. This is in part due to scarcity of banks' capital to invest in further technology change, especially where already tightened spreads limit the incentive to commit further resources. Furthermore, the growth of electronic venues has resulted in a fragmentation of liquidity, reversing the advantage that was initially enjoyed. We would highlight that more electronic trading will not automatically lead to more liquidity.

Additionally, increasing use of electronic trading when dealing with less sophisticated clients may be limited where assessment of appropriateness is more difficult to achieve compared to the traditional methods of execution (i.e. voice). Moreover electronic trading will not suit the needs of all such customer, meaning they will continue to rely on the traditional methods of dealing.

Addressing the question of transparency, RBS would highlight that transparency in significant, non-flow transactions can be detrimental to the effective risk-management of the deal. A market structure that provides visibility of market hedges or price stabilisation, for example, could undermine the deal or market stability. Similarly, too many venues detract from market liquidity, due to fragmentation. Additionally, a higher number of venues could conceivably result in increased costs and complexity of trading due to the individual rule book interpretation required and costs of infrastructure integration.

RBS would also highlight that the increased transparency requirements of MIFID II could lead to wider spreads in some cases from market makers as dealers will be obliged to make a price tradable to all market participants for a period of time.

E-trading will facilitate the ability to conduct automated trading. From a supervisory perspective it is worth considering that automated trading is likely to be easier to surveil, given it is wholly monitorable and provides the opportunity to hard-code the rules and regulations into the trading mechanism. The counter-argument to this is that it will create a new class of risk, in that supervisors will need to understand coding and system architectures to ensure that the trading platform does not contravene market policies and standards in ways that people cannot.

Summary

- The importance of e-commerce has increased by virtue of market pressures as opposed to regulations
- More electronic trading is possible but only if the outcome of the structural change is desirable to clients; e-commerce does not automatically mean better liquidity
- Transparency is not always beneficial for clients, especially in deal-driven transactions; it is not an end in itself
- Lack of standardised products and new regulatory drivers means further progress is likely to be slow

Question 6: 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?

It is possible and indeed desirable to standardise some parts of the corporate bond issuance process if it assists clients, for example the listing, rating and settlement processes. We would take the view that the Eurobond market is already standardised in many respects. However, issuers have a corporate obligation, to the extent they decide to raise funds in the capital markets, to do so at the best price and on the best terms they can. Total standardisation of the issuance process would interfere with this flexibility, and adversely impact their ability to choose the most advantageous deal size, maturity, coupon structure, covenants and other conditions that best suit their needs. RBS would highlight that a number of the biggest, most highly rated sovereign and agency issuers have tried to pursue issuance standardisation for some time, yet are obliged to include bespoke features in order to maintain investor interest.

There is no single issuance structure that suits all issuers. There would be significant reluctance amongst issuers to relinquish the right to select their own issuance terms. Standardisation might be particularly disadvantageous for smaller or less frequent issuers with bespoke funding needs. It is important that these issuers have the freedom to negotiate terms and conditions that suit their own business model or corporate structure, and that these are consistent with other finance documentation and meet their funding patterns. Removing this flexibility would make it harder to achieve the best borrowing terms.

For Rates and Credit products, this trend is repeated with many operational features such as payment frequency and day-count convention being harmonised, as well as the legal framework. However, as with corporate bond issues, the client requirements continue to provide support for OTC features that make full standardisation impractical.

Recognising that markets will likely require regulatory encouragement to commit to further standardisation, we would advocate careful consideration of the impact this would have on clients' ability to manage their risk and funding needs. Other considerations would be the impact on accounting treatment and the overall level of competition and liquidity in the markets, as well as any related development in the derivatives market to ensure the ability to hedge continues to exist.

Summary

- Standardisation of common features are already in-train or in place for bonds, however the more bespoke features of bonds are reflective of client demand and investor risk appetite and are difficult to standardise
- Standardisation of other Fixed Income products is also well progressed but again client demand drives unique deal features and structure
- Forcing more standardisation risks reducing the ability of banks to meet clients' needs, in terms of funding and risk management

Question 7: Fixed Income – Should the New Issue Process be more transparent, via auctions, allocation publication or some other route?

The new issue process needs to balance the interest of issuers and investors. An auction style process is unlikely to result in a better outcome for issuers. The appeal of issuing via a Syndicate is that the bonds are sold to investors who match the issuer's preference in terms of geography, currency, sector or industry and investment strategy; price is just one consideration.

An auction mechanism already exists for certain new issues (in particular sovereign bonds and issues by frequent, highly-rated issuers) but there is little reason for making it a mandatory requirement, especially given the need for approved, bespoke documentation for most new issues. Furthermore, the auction process does not allow a borrower to decide which investors receive bonds on issuance, something that is important to many corporate issuers. It may also have a negative impact on liquidity in the market and the ability of issuers to raise funds efficiently, and introduce volatility. One of the aims of the debt capital markets is to match the objectives of issuers with the objectives of investors. We believe the most efficient process for matching buyers and sellers of debt securities in the primary market, taking all these objectives into account is the current syndicated distribution model.

Investors are given sufficient information to determine whether to buy the securities; they are not compelled to invest if it is not attractive. The details of investor bond allocations are subject to confidentiality. Some investors would be very concerned should this confidentiality be diminished, and it might not be in their interests for their investment strategies to be made public without their consent

We believe that the current practice of providing a high level breakdown of the investor allocation by sector, country, which some new issues already make, is adequate.

Summary

- The new issue process needs to consider both issuers and investors
- Price is not the only consideration for either issuers or investors
- Common, high-level disclosure about the process would be beneficial, but more granular disclosure would drive asymmetric benefits

Question 8: Are there risks associated with internalisation and last-look practices? Are there barriers preventing increased pre-and post-trade transparency in FX markets?

RBS believes that internalisation is a risk-reducing mechanism. When discussing internalisation, it is possible to differentiate market-making, where principle capital is committed and e-commerce liquidity pooling efforts whereby internal efficiency is maximised. Both, however, underpin the market by reducing the risk of liquidity vanishing and providing better pricing to clients. Internalisation is not a new phenomenon in the field of risk-management. However, the reason it has grown so dramatically is a combination of technology enablement, and a desire by market makers to limit the execution costs as well as the opportunity to be arbitraged on the core market venues.

Last look is the basis upon which all OTC markets operate. Prices generated and published to clients are 'invitations to treat' under English contract law. Clients' requests to deal on these prices are 'offers' and dealers' 'acceptance' of those requests create the contracts.

The use of last look allows dealers to make tight, consistent prices to customers and maintain low rates of rejection caused by latency. The issue with last look is not the use of the practice but rather its potential abuse. This can happen if dealers apply asymmetry in their application of last look or use the ability to have last look to place orders in the market before accepting or rejecting the client orders.

This can be mitigated with rules around prevention of asymmetrical application and rules around not allowing dealers to place orders in the market ahead of acceptance. Removal of last look capability would create significant difficulties and complexities that would only serve to make the market less functional and generate a poorer client experience.

Summary

- Internalisation is a significant positive, promoting competition, tighter spreads and deepening liquidity
- Last-Look is helpful to make markets effective but also creates opportunities for p&l manipulation
- There are no barriers per se but market structure limits transparency

Question 9: Are there barriers impeding the development of more comprehensive netting and execution facilities for transacting foreign exchange fix orders?

It would be structurally efficient to net down the inter-dealer fix positions but currently there is no commercial offering to facilitate this. To efficiently and commercially offer this service would likely require the leverage of an existing netting platform such as CLS, but RBS is not aware if this is a priority for them. With regulatory support, the construction of a wholesale-only industry utility netting mechanism would allow for netting with minimal friction.

Taking a step back, RBS believes the practice of dealing at the fix requires challenge as there are a number of peculiarities that warrant consideration:

- Dealing at the fix is a somewhat anachronistic strategy that pre-dates the existence of current-day algo dealing platforms. It is a direct consequence of principles engaging agents to carry out their execution requirements
- Clients are unlikely to achieve better-execution by dealing at the fix, when algo-based strategies can offer more efficient dealing in terms of spreads and deciding on point of entry to the market
- Dealers have historically not charged a fee or spread for dealing, but this was recommended by the FSB in the recent FX Benchmark report. This additional cost may alter the current dealing patterns

Consequently, further development is unlikely to proceed without regulatory encouragement or mandate.

Summary

- Effective netting requires regulatory support and approval
- Trading at the fix rate is not a commercially rational behaviour

Question 11: 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?

All other things being equal, arbitrage will tend to eliminate structural issues as the fundamental rules of economics are applied; markets are generally efficient on the proviso there is adequate competition. In the instances where there are structural differences between international markets, this can often be attributed to regulatory policy and application divergence.

Relevant examples of regulatory themes that are not aligned internationally are the trade and transaction reporting, non-equivalence of third-country CCPs and the margin rules for uncleared derivatives. The absence of common rules and requirements has led to system complexity and the creation of new risks of non-compliance with a local requirement.

This risk, accompanied by the constant cost and time to deliver the requisite technology changes to meet the different regimes' needs is leading to banks making operational decisions about the markets they are present in. Whilst this may solve for a domestic regulatory agenda, by de-risking domestic banks to an appropriate size versus domestic GDP, it is having a significant impact on cross-border activity and transfer of capital. This in turn is impacting clients' capacity to operate.

RBS believes that IOSCO is ideally placed, as an international body to move for greater alignment between the different geographies and regimes. We would encourage them to take a more active role in this theatre, in order to develop broad agreements of equivalency, in line with their focus on the IOSCO Cross Border Regulation task-force report. RBS would also encourage the Bank of England, whilst holding the chair of the FSB, to progress this

agenda. This in turn will allow unique yet understood differences by regulatory regime, whilst providing a suitable mapping structure between them.

RBS recognises that there can be occasions where interim relief may be required and would advocate an EU equivalent of the no-action relief facility that the US regulatory authorities can apply. This would provide a mechanism to avoid unintended consequences where new regulations are inconsistent with third-country regimes or need refinement.

Summary

- Principles of recent regulatory change are well-founded but execution has been rule-based as opposed to principles-based, giving rise to market regulatory inefficiencies
- Underlying domestic agendas of NCAs also means that coordination is difficult to achieve
- Accommodating principles of equivalency are required to avoid material disruption to international trade and client strategy execution

Question 18: In what ways might competition in any of the key FICC markets usefully be addressed by the competition authorities (e.g., by assessing the state of competition in relevant markets)?

Competition can be reviewed through multiple lenses and should be considered as such:

- Dealing: the tightening of spreads in the majority of the FICC markets over the last five years would suggest that competition has increased significantly. However, the increasingly fractured nature of liquidity does not mean that this benefit is universally available.
- Structural: as mentioned in RBS' submission to the FCA wholesale competition review, RBS believes that trading venues or execution services should be separated from clearing services as there is a risk that combining such services would reduce competition in relation to execution/pricing for clients and because of the advantage this might give in providing clearing services resulting from the increased visibility of a client's deal flow.
- Clients: there is anecdotal evidence in M&A and IPO scenarios that clients prefer to execute their risk management activity with the advising banks. Whilst this may be for information security reasons, there is a risk that bundling of the advisory services with associated risk-management dealing hides the true cost of each element. This is exacerbated by the increasingly limited number of banks offering "full service" banking, meaning that clients may not get optimal pricing for the individual components of their transactions.

Since the financial crisis, there has been considerable consolidation by market makers (e.g., JPM/Bear, BofA/Merrill, Lloyds/BoS) and there have been some notable exits from the FICC market (e.g., UBS). Exacerbating this development, the on-going barriers to entry for new global market entrants are prohibitive, and the new and additional costs for present

participants to remain as market-makers are significant. We see a scenario similar to the US Syndications markets evolving, where three market leaders hold over 70% of the market, and no other participant holds more than 5%.

Whilst there are still new regulations and structures developing, a continuation of this trend of concentration is troubling, and RBS would see merit in exploring the following themes:

- For the incumbent market makers, a greater degree of regulatory surveillance will be required. This will ensure that the remaining institutions continue to operate fairly, despite the lack of competitive tension. The implementation of MIFID II, with increased pre and post-trade transparency and more detailed trade-reporting will enable an increased level of scrutiny.

- Regulators could encourage new entrants through the provision of graduated capital or supervisory requirements, effectively allowing a grace period for new entrants to get set up. Coupled with active supervisory engagement, this could allow new entrants to temporarily overcome the regulatory hurdles to setting up.

- Another barrier to entry of new market participants would be the substantial static data requirements (e.g., AML, KYC, EMIR/DF/MFID classification). Regulators could encourage a single, central data solution that would reduce the technology and staffing requirements for potential new entrants.

Another feature of the markets since the crisis has been the retrenchment of a number of global banks to a more regionalised model. Having noted already that the cross-border coordination by regulatory bodies is demanding, finding a way to address this shift will be a challenge. One mechanism to consider would be for the domestic governments and NCAs to encourage new entrants into their domestic markets from domestic entities i.e., Sterling Bonds in London via UK Asset Managers and AIFMs, or Asian Currencies and Bonds in Asia from Asian regional Banks.

Summary

- This is a complex question to answer as the evolution of pricing and liquidity, market structure and client interest proceed at different speeds

- Care should be taken to prevent further regulatory overheads from forcing current market participants to leave the market or create barriers to new entrants

- There are a number of potential actions that could encourage competition

Question 21: Do current domestic and international initiatives by industry and regulators to improve the robustness of benchmarks go far enough, or are further measures required?

LIBOR rules are in place in the UK and further benchmark regulation is in-train within the EU. For the specific indices, deep analyses and structural changes have been completed within the affected business. In turn this has led to more thinking around ‘what good looks like’ in these and other benchmark theatres.

Decreasing activity in the interbank market has challenged the Libor market as being representative of market activity and at times of stress will evidence high credit spreads in Libor pricing; counterproductive for borrowers and the larger economy. However if the market tries to adopt a new reference rate – such as a futures, GC or OIS-based rate – customers will dislike the change, disruption, and re-documentation required. Post the fines and reviews, absolute clarity is required on what 'manipulation' and inappropriate look like, as a new reference rate will be in a tradable product, and subject to interpretation of activities around it. Selection as a benchmark could otherwise be counterproductive for that product as market participants may reduce activity in it.

Assuming that benchmarks commute to a more observed pricing basis, there are a number of process improvements for the non-submission-based benchmark activity that RBS would propose as a minimum standard, using the WMR Fix as an example:

- Client orders are only accepted prior to an accepted cut-off point for a fixing point – e.g., for 16:00 WMR rate, all orders are in by 15:40
- Clients would acknowledge that the bank may enter the market before the fix in order to hedge their order-book risk
- Benchmark orders should be managed in a physically segregated manner, using unique dealing accounts
- Surveillance of the deals and coms associated with these unique dealing accounts should be completed
- The Fix order-book should be segregated so traders cannot see it on the BAU desk and salespeople can only see their own clients' orders
- Trading visibility of the order book should be kept to aggregate positions
- Clearly defined windows of time should be allocated to the management of the benchmark-related risk
- Oversize orders should be reviewed between Sales and Trading supervisors to confirm execution strategy, in turn clarified with the client
- Execution that is believed to have moved the market should be escalated to senior management and potentially to the regulator

For structured business, the prevalence of basket trades means that multiple institutions have notes in issuance, referencing a manufactured rate. Given the reliance on the construct of proportionality, it is unclear when a basket transaction would fall within the benchmark regulations. An extensive Q&A paper on this would be helpful.

Summary

- Submission-based benchmarks are or will be legislated for – LIBOR-type rules are clear and largely now business as usual

- Benchmarks where the index is constructed from observed and executed pricing should be encouraged, and need 'Best in Class' guidelines, that are industry-led, accepting some expert judgement may still be necessary

- Clarity is required around the application of the benchmark regulation, notably for structured trades that reference a constructed valuation (e.g., basket trades)

Question 23: What additional changes could be made to the design, construction and governance of benchmarks?

Broadening the underlying market data should make the resulting benchmark more robust. Using actual rates within a longer window will reduce the opportunity for subjective input or manipulative activity to influence the rate setting. It is also intuitively easy to understand, that a wider observation will deliver a better rate. RBS would recommend a period of at least 5 minutes.

Another potential outcome of broadening the input would be that clients will be unable to deal specifically at the fix. This is a key step in reducing clients' reliance on benchmarks, but will require consideration of alternative mechanisms to allow clients to discharge their best-execution and performance measurement needs.

Summary

- Referencing dealt and deal-able pricing over a longer period of observation will improve the basis of the benchmark in question

- Taking this approach could also reduce the reliance on benchmarks by clients

Question 28: 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?

There are a number of areas that can give rise to the concerns mentioned in the question, including but not limited to:

- In auction processes
- Banks' arrangements with respect to pre-hedging a new issue in order to manage the size of the market hedge

There is currently no forum or mechanic where or by which market participants can clarify their understanding and application of applicable market standards. RBS believes that

establishing a forum to work through uncertainties may be helpful to establish such clarity and to seek to ensure that regulatory authorities remain close to current market practice.

Summary

- FICC Markets are not homogenous – there are significant differences in liquidity and practices
- Where there are uncertainties as to how ensure both appropriate prudent risk management and the effective filling of client orders takes place in these diverse markets, this can give rise to the concerns described in the question
- There is no venue or forum to discuss and ratify industry and the regulator's view on processes and products where these uncertainties exist

Question 31: 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?

RBS is supportive of the introduction of a compulsory professional qualification for all FICC traders and sales staff. This could be a cross-industry coordinated professional qualification that can be developed by leveraging relevant curricula from existing and established industry qualifications (e.g., CFA, ACT, ICAEW, and ACCA).

Additionally, continuing professional education designed to reinforce knowledge of the market rules and regulations as they pertain to the FICC markets should be a mandatory post qualification requirement. All registered members of the professional body should complete continuing professional development (CPD) that focuses on compliance, regulatory, ethics, sales and trading practice, as demonstrated by the Financial Industry Regulatory Authority (FINRA) in the US. This CPD requirement will serve to remind all staff of the standards to which they should adhere.

In order to strengthen the role of front line managers, there should be provision for a 'top-up' certification for supervisors that would be required upon assuming managerial responsibility. The introduction of the Individual Accountability Regime also provides an opportunity to increase greater accountability across a wider range of staff in FICC markets. At present the proposals on certified staff would exclude non-retail CF30s. We would suggest that the certification regime be expanded to all CF30s

The FICC industry should prescribe standards of training experience, competence, a single principles-based Code of Ethics and Standards of Professional Conduct similar to the other professional bodies, for example Institute of Chartered Accountants England and Wales (ICAEW) and Association of Chartered Certified Accountants (ACCA). Ethics training should be fully integrated across all syllabi, levels/grades of membership and feature in all examination assessments of the professional body. On admission to the professional body, members should agree to abide by the Code of Ethics and Standards of Professional Conduct, similar to that enforced by Chartered Accountants Ireland and the Dutch banking regulators. Members should self-certify on an annual basis their adherence to the

professional body's Code of Ethics and Standards of Professional Conduct. There should be disciplinary consequences for breaching the code such as reprimand, fines, suspension and expulsion from membership.

Recognising that whilst a global body in this vein would be ideal, it is unlikely to be formed in the near future. RBS would recommend that focus initially be brought to bear on the UK market; this will be easier to progress and will also allow proof of concept.

Market participants need to have confidence that the professional body will enforce these standards and requirements. The body's Disciplinary Review Committee should involve non FICC industry members and suitably qualified lay members of the public for the purposes of restoring trust and confidence that market participants will apply the standards consistently and rigorously.

Summary

- Establishing a professional qualification is believed to be a minimum requirement
- On-going continuing professional development would be a natural extension of this
- We would encourage the set-up and support of a professional body promoting standards in the FICC markets; initially focus on the UK but aim for global coordination

Question 38: 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?

RBS feels the scope of the proposed new BSRC professional body is limited, given it is primarily focused on UK banks and building societies and excluding the international operations of UK banks. The BSRC's concentration also appears to be more on standards of behaviour than on competence within the banking system (Richard Lambert Banking Standards Review 19 May 2014 p5). These two qualities are arguably intertwined and cannot be completely separated, and RBS believes they deserve equal focus - 'Competence may be defined as the behaviours (and, where appropriate, technical attributes) that individuals must have, or must acquire, to perform effectively at work' (CIPD – Chartered Institute of Personnel Development, Factsheet – Competence and Competency Frameworks, updated Aug 2014).

There is no professional body for FICC markets participants to align to. Rather than starting a new professional body initiative there is scope for an existing professional body already acting in the financial services industry to extend its remit further. Given the international nature of the FICC market there is a need for a global professional body similar to the CFA Institute, the Association of Chartered Certified Accountants (ACCA) and the Chartered Institute for Securities and Investment (CISI) to promote higher standards in both behaviour and competence in the FICC markets.

A global professional body would encourage a level playing field with globally accepted norms of behaviour, would greatly facilitate the free movement of international talent and

ensure a minimum threshold of qualification is achieved. Such a global remit may be aspirational, but it would be a key determinant of its relevance and credibility in addressing perceived deficiencies in fairness and effectiveness in the FICC markets. The global body, consisting of both bank and non-banks firms that operate in the FICC markets would draw up that professional body's Code of Ethics and Standards of Professional Conduct and present them to the various international regulators for comment and feedback. There are already good practices in place where professional bodies oversee both the competence and behaviour of its members and firms who operate on a global basis.

A global professional body should ensure its independence and credibility through a rigorous and consistent approach to governance, discipline, disclosure and reporting arrangements. The same professional body would administer the professional banking qualification with relevant post qualification top up programmes for the different specialist streams and for supervisors who operate in the FICC markets. (See response to Q31).

FICC participant firms should make these professional qualifications a required step in a successful career in FICC markets. Adherence to the Code of Ethics and Standards of Professional Conduct should be a requirement in all future employment contracts. FICC participant firms should incorporate undertakings into their contracts with market counterparties for the purposes of compliance with the FICC Code of Ethics and Standards of Professional Conduct.

RBS acknowledges that the creation of the professional body and the associated examinations will not provide a fool-proof solution to prevent unpalatable behaviour. It will however provide a demonstrable and significant hurdle to new entrants to the market, in turn allaying some of the wider concerns over the quality of the individuals working in the global markets business.

Summary

- The scope of the Banking Standards Review Council could be broader
- FICC Employees would benefit from membership of a professional body covering sell and buy-side, both for learning and reputational reasons
- This body, over time, could be the channel by which employee's professional reputations could be measured

Question 41: 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?

Existing systems already allow surveillance of communications and trading patterns, with automated voice monitoring likely to be available shortly. The constraining factors at present are:

- Ensuring coordination between the different platforms, so that trade, communications and surveillance can link up, along with other supervisory reports
- Surveillance staff need to be up-skilled with the requisite control frameworks in place to ensure appropriate disposition and escalation of alerts
- Investment costs have increased substantially in the last years, in a cost-constrained environment

The next stage of development will see detailed trader profiling via internal data components, cross-referenced with market-wide trade data. This will make the performance of individual traders more transparent, and highlight previously un-noticed correlations, for example recurring p&l with a particular broker. This will be supported by developments in market data, plus improved trade reporting under MIFID II.

Further development will come about through a number of ‘softer’ developments. Industry-led market standards will drive cultural change, which combined with a greater willingness by institutions to punish offenders and an increase in supervisory training will give rise to greater control. These developments should be encouraged.

Summary

- Recent acceleration has led to a squeeze in terms of system, personnel and investment capacity
- Going forward, new issues will be highlighted by cross-referencing market data and internal information, subject to investment availability. Challenge will be handling the complexity
- Other tools would revolve around cultural shifts and training for supervisors