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Fair and Effective Markets Review
Bank of England
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By email: FEMR@bankofengland.co.uk

29 January 2015

Subject: **Nomura's response to the Fair and Effective Markets Review consultation document – *How fair and effective are the fixed income, foreign exchange and commodities markets?***

Nomura is a leading financial services group and Asia-based investment bank with worldwide reach, providing a broad range of solutions tailored to the specific requirements of individual, institutional, corporate and government clients through an international network in over 30 countries. We are based in Tokyo, with regional headquarters in Hong Kong, London and New York.

We are grateful for the opportunity to respond to the Fair and Effective Markets Review consultation document – *How fair and effective are the fixed income, foreign exchange and commodities markets?* This review is taking place at a very important juncture in the evolution of the FICC markets, with pressures on these markets arising from conduct issues, structural global economic pressures, capital constraints and regulatory change. We are deeply committed to ensuring the UK markets work for all interested parties. Our Japanese heritage and active participation in many of the markets covered by this review makes us well-placed to comment. We hope our comments prove to be useful and we look forward to engaging, as appropriate, with the Review as its work progresses.

The FICC markets are an essential part of the economy and specifically the fixed income markets play a vital role in credit intermediation, providing for the efficient allocation of financial resources, and in current circumstances facilitating the recapitalisation of commercial banks through deleverage.

Nomura has a somewhat unique perspective on the UK FICC markets as a pure-play broker dealer. As well as being among the most active primary dealers for the UK Debt Management Office, Nomura is a leading market-maker in the credit and foreign exchange markets.

Regulatory oversight is a powerful tool that can be used to counter and augment other external influences on the market whilst simultaneously addressing the integrity and efficiency of the market place. To achieve this, we believe it is essential that regulation is well thought through, not only for the objectives that are directly targeted, but also to avoid unintended consequences.

In our responses below we present comments on three core pillars that we feel important for this review:

1) Transparency and its interplay with liquidity

2) Market practice in client engagement (best execution)

3) Market abuses and conduct

These three pillars interlink, but are not the same. The solutions applied must also demonstrate separation of thought whilst recognising the interplays that exist. While we remain concerned about inappropriate conduct in FICC markets, care must be taken not to harm the market structure in an isolated attempt to redress this conduct.

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We elaborate on specific questions in the consultation document below.
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?

We are greatly encouraged to see the concept of balance set out at the heart of this review. As with any fragile eco system, that is influenced by a wide range of external forces, that can be exposed and unexpected consequences can occur. In light of this, where changes are either required - or desired- they must be applied with care and consideration for the balance of that eco system.

Fair and Effective can each mean many things to any given audience. The definitions presented in the review in our view are succinct and clear.

We recognise that the association of "fair" with "transparent" and of "effective" with "liquid" can be extremely helpful. However, all too often transparency and liquidity are confused with each other, or their linkages not understood. This, importantly, includes the different impact of pre-trade and post-trade transparency requirements on liquidity.

This review comes at a time of structural imbalances in some sections of the FICC markets, and a number of pressures on the market environment. These pressures are coming from a broad range of influences:

i. Structural global economic activity – state of the economies and government monetary responses
ii. Material imbalances between buy side and sell side portfolios
iii. Market concentration and symmetry of views
iv. Conduct issues and necessary responses
v. Capital constraints – commercial and regulatory
vi. Electronification of markets
vii. Market structure changes

It is not hard to see how the wrong combination of the above influences could cause major disruption to the market: a period of reduced QE, rising interest rates and a general withdraw from fixed income inventory from an ever more concentrated and homogenous fund management community, coupled with capital constraints and transparency requirements that have led to withdrawal of market maker liquidity, could create significant imbalances and volatile price movements, with associated disruption.

Commentary on the state of the fixed income markets in particular is wide, and there is a notable common theme expressed of concern for the market[1].

To illustrate the potential, it is worth reflecting on a recent imbalance in the US Treasury market. On 15th October 2014 we had an indication of the potential consequences of the above combination of factors. On that day, the 10 year US Treasury yield "crashed" from 2.2% to 1.86% before regaining ground. Assuming normal distribution this was a 7 standard deviation event, illustrated in the charts below.

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[1] For examples see:
- Financial News, 5 January 2015: "Navigating a route through the desert"
- Financial Times, 16 October 2014: "Markets are parched for liquidity despite a flood of cash"
- BlackRock viewpoint, September 2014: "Corporate Bond Structure: the time for reform is now"
- ICMA, November 2014: "The current state and future evolution of the European investment grade corporate bond secondary market"

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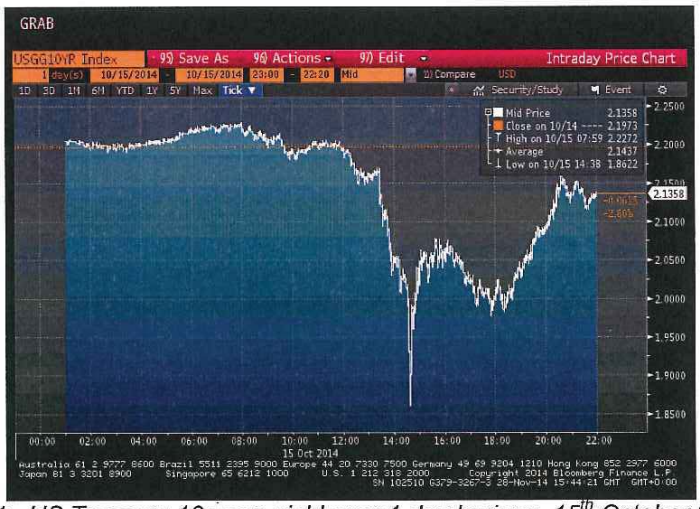

Fig 1: US Treasury 10 year, yield over 1 day horizon, 15th October 2014

Fig 2: US Treasury 10 year, yield over 30 day horizon, centred on 15th October 2014

This event represented a "perfect storm" combination of weak economic data, a common directional imbalance (in this case, across the investment segments, market participants were either underweight or short US Treasuries), and transparent electronic trading mechanisms upon which liquidity was withdrawn as participants reassessed the supply/demand balance.

Against this backdrop, we are also close to the finalisation of requirements that will be applied to the FICC markets under the MiFID II regulations. Transparency, in particular, will be at the heart of this model.

The mandate to increase transparency largely stemmed from G20 commitments, and there is broad agreement across the industry that improvements to transparency are required. However at times this aim has been expressed without a sense of proportionality: a comment from a European Commission official of a strategy of "transparency at all costs", and regret expressed by Michel Barnier that "the Commission's proposed ambitious transparency regime for non-equity instruments, such as bonds and derivatives, has not been fully achieved"[2]

Excessive transparency, particularly pre trade transparency, could be another shock to the FICC markets in two years' time. The risk for the fixed income markets in particular is that a rising interest rate environment coincides with material liquidity issues. These liquidity issues - created by capital

[2] European Commission press release, 14 January 2014

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constraints and this new transparent market - could cause material price shocks to arise, which in turn may destabilise the market further.

Care must be taken not to use MiFID II to create either the wrong structure without this necessary balance, or an inflexible structure where the balance cannot be altered. MiFID II, a great experiment in non-equity transparency, comes into effect 10 years after MiFID I, and seven years after the MIFID Review commenced. This long gestation period should not subsequent constrain for market structure adaption.

We encourage the Review to:

- explore further the notion of liquidity and find suitable metrics to test and track how liquidity evolves, and
- explore ways in which calibration of the transparency parameters of MiFID II can be controlled either by national authorities or by ESMA centrally, in a flexible manner, in order to both establish and over time to maintain a balance between liquidity and transparency

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?

Table A is a helpful framework for evaluating the fairness and effectiveness of FICC markets. It is important that incentives for firms and individuals are aligned in order to provide for fair and effective markets. Market structure should be calibrated to ensure that all players in the market have fair access and actors should be clearly aware of that the highest standards of conduct are not only expected, but required. Once these principles are embedded, which will take time; we will have taken huge strides towards more fair and effective markets.

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?

We have no comment to make on this question

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?

Individual asset classes are discussed below.

Across all asset classes, MiFID II is the main in-train regulation affecting the market structure of trading FICC instruments. This regulation is seeking to improve the transparency of these markets, and as noted above the balances between transparency and liquidity will be essential. It is expected

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that the combination of transparency and best execution requirements will lead to an evolution of market structure in these businesses.

Technology can, and has in the past, played its part in structural evolution. A particular example of this is in the equity market. It is interesting to note the continued debate as to how far technology as opposed to regulation has driven changes in the equities asset class. We can however expect that times of regulatory change (MiFID I for equities and now MiFID II covering FICC) can catalyse technical innovation as entrepreneurs see opportunities arising from change. This is already being evidenced, for example, in the fixed income markets where a number of initiatives are being introduced.

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?

Electronic trading brings a range of benefits to markets, including greater ease in finding liquidity, and operational efficiency to the trading process. It can also facilitate new liquidity by leading to the introduction of new market making activity.

The greatest experience to date of electronic trading has been in the two most liquid asset classes: equities and FX. Electronic trading encompasses a wide range of activity, including:

- market making
- direct client electronic execution
- dispersed venue connectivity
- smart order routing between venues
- working algorithms to manage executions over time
- arbitrage

Some combinations of the above activities are possible in fixed income markets, but it is unlikely in the near term that most of these would arise due to the inherent levels of liquidity. Realistic aspirations for electronic trading of fixed income products include:

- direct client electronic execution – "hittable" quotes
- use of electronic networks for price and liquidity discovery in RFQ activity
- creation of central limit order book (CLOB) venues with associated connectivity

The question asks about greater use of electronic trading, and a more transparent market structure. The two are linked but will not necessarily always go hand in hand. There are no fundamental barriers to a more transparent market structure, and MiFID II is taking this asset class in that direction. Innovation is also likely to lead to a natural growth in electronic trading over time. The biggest constraint to electronic trading development is, however, liquidity and it is possible that increased transparency harms liquidity, potentially to the detriment of electronic trading growth.

Technology is likely to also play a role in widening access to fixed income markets from retail segments. Combining for example retail flow with dealer mechanisms - that are perhaps more used for "odd lot" trading from the institutional segments - could help create liquidity provision in retail markets.

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?

From a liquidity and market structure perspective, standardisation of bond issuance is desirable. Re-issue of existing lines or other methods of standardisation would compress the secondary trading activity in these products and create greater levels of liquidity in a smaller instrument universe.

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Liquidity concentration then in turn allows for greater transparency, greater trading likelihood, and for market structures to evolve to become more efficient through electronic trading.

However this secondary market aspiration must be considered against the underlying drivers for fragmented bond lines, ultimately structured to suit the needs of corporate issuers. Whilst some bond line reissuance does happen, typically each new issue is tailored to meet the capital flow needs, including payment schedules and currency, or the treasury functions.

To make changes in this area, the motivations and incentives of the corporate issuers needs to be considered. This should include consideration of whether bespoke funding needs can be addressed using a combination of standardised and add on products, as well as whether any economic incentives exist for the corporate issuer to seek a changed outcome.

The corporate issuers' views on secondary market liquidity will be key. As we look to MiFID II, we note too that the ESMA advice is to determine corporate bond liquidity classification (and hence transparency) based on issuance size thresholds, and it is worth considering further whether such classification will incentivise larger or smaller issues.

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?

Transparency is vital to the functioning of the primary markets for bonds, but we do not believe that the auction mechanism is the best way to enhance it in this market. Standard practice in the syndicated bond market provide a high level of transparency through publication of primary distribution statistics according to geographical location and investor type.

Compared to syndication we believe that the auction mechanism may increase volatility particularly in the immediate after-market post pricing. The inability to be selective about investor allocations could also adversely affect bond performance and price stability in the secondary market and therefore impact both issuer and investor.

While we understand the need for transparency it is important to look at the impact it will have on the wider market in specific products. Forcing new issue bonds through the auction mechanism would likely have the unintended consequence of making markets (credit markets in particular) less liquid and more volatile.

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?

Nomura recognises the challenges created by the last look practice in FX as described in section 5.1.3.

We encourage the Review to look at, and potentially introduce, guidance on the utilisation of this capability.

Last look serves as a control primarily to allow for validation of pricing ahead of deal closure. It can also serve as a control against multiple trades on the same quote, from different sources, where quotes are published to multiple clients. This last feature is relevant in a market that operates OTC, rather than for example equities, where a single quote may sit on a central limit order book and can only be traded once.

This feature could, however, be used as described in the consultation document to delay a fill and see any market movements ahead of choosing to trade. For the consumers of such services, it would be preferable for there to be better delineation between last look as a validation process and last look as a holding period. A tight (near zero) overall period would reduce the risks of abuse.

We have seen internalisation as a healthy mechanism across all asset classes, helping with capital flows, trading efficiency, risk management and hedging, and pricing. We believe pricing in FX is efficient and benefits from this capability.

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It is not right to directly associate internalisation with a lack of transparency. By virtue of the way FX trades, the pre trade transparency provided by quote dissemination is not itself affected by existing levels of internalisation.

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

Nomura participated in the GFMA response[3] to the FSB consultation on benchmarks in August 2014, which covered the topic of FX fix orders.

In this response, agreement was noted that a central netting facility would be beneficial in addition to firm-only netting that currently takes place. There are challenges and limitations too in this approach, including the commercial viability of such a central utility, and handling of the remaining residual risk positions.

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?

We have no comment to make on this question

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?

FICC markets are international, whereas regulation operates at the national level. International regulatory consistency is desirable if we are to avoid regulatory arbitrage. We would encourage supranational bodies such as the International Organization of Securities Commissions (IOSCO) to participate actively in this process.

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?

We identify two sets of conflicts in FICC markets. Those as a result of new issuance and a breakdown in the Chinese Wall procedure and those where there is conflict between two counterparties trading on a principal to principal basis.

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?

We believe that existing Chinese Wall procedures are adequate to manage any potential conflict of interest and that principal to principal risk is mitigated by a clear understanding of the caveat emptor that applies in the markets. This, together with the fact that professional buy side firms have a procedure in place to protect their clients in their interaction with the wholesale markets, should minimise the vulnerabilities these conflicts may pose.

[3] http://www.gfma.org/correspondence/item.aspx?id=613 (Section 6)

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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.

Adequate competition plays an important role in the fair and effectiveness of markets and in ensuring that returns to market making are not excessive. Regulation in the form of capital requirements and high barriers to entry mean that some FICC markets tend towards oligopoly and prevent the competition that may help deliver fairer markets.

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?

And

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?

We don't see technology as the solution to the FICC efficiency problem. Clearing seems appropriate for equity markets where you have very large pools of homogeneous securities and very large numbers of heterogeneous investors. However, in non-governmental fixed income markets the small pools of homogeneous securities and small number of homogeneous investors does not naturally lend itself to the same solution.

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?

We believe that the big buy side firms are highly qualified to enforce market discipline. However it is not clear the extent to which smaller buy side firms can also do so. An honest broker, which may take the form of an electronic platform, would help improve market discipline.

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)?

And

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

And

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?

We believe that there are a number of measures being implemented and to be implemented, such as MiFID II, which will introduce transparency, promote competition and deliver more robust FICC markets. The UK authorities should fully assess the impact of these regulations before considering further regulatory or legislative measures.

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Benchmarks: For all questions in the benchmarks section (Q21-26)

Benchmarks are provided at the behest of the buy-side. To the extent that they have value it is important that providers are not disincentivised by excessive penalties.

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?

In certain areas of market practice there is sufficient clarity on standards and the associated legal and/or disciplinary action. Insider trading, market manipulation and collusion are behaviours that have clear and established penalties. Matters concerning suitability and ensuring duty of care to your client are areas which we may benefit from case study.

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?

We recognise the uncertainties that are presented in box 7 of the consultation document. It is of note too that these uncertainties have been further highlighted and extended by the FCA Thematic Review on Best Execution and Payment for Order Flow (TR14/13) of July 2014.

The FCA Thematic Review noted that "*There was a poor level of understanding of which activities are covered by the obligation to provide best execution, particularly in quote-driven markets. Frequent attempts were made by firms to limit the scope of the obligation in their dealings with clients, often through the use of general 'carve-outs' which are not permissible or through continued reliance on outdated market conventions*"[4].

Here the FCA challenges firms to rethink where the boundaries of "working on behalf of clients" start and end, and brings into question some of the presumed positions that have existed over the seven years of MiFID I.

Many market participants under MiFID I have operated on the basis that dealers in the wholesale (professional client) market in FICC products broadly trade on a request for quote (RFQ) basis and that in this model dealers are not acting on behalf of clients.

Guidance that has established this position includes the CESR issued Question & Answers document on Best Execution under MiFID. This document includes a letter from the European Commission stating four considerations to help determine reliance. The letter states that "prima facie application of these factors is likely to lead to a presumption that in the wholesale markets clients do not rely on the firm"[5].

There are however transactions that take place on these desks that are not RFQ driven, and it is possible to see how uncertainties can arise in these situations.

We recognise that this specific discussion topic needs to be aligned along two dimensions. Firstly clarity from dealers as to their service models and accompanying discipline of dialogue with counterparties, and secondly through collective industry wide standardisation of terminology and

[4] FCA Thematic Review on Best Execution and Payment for Order Flow (TR14/13) July 2014, p5
[5] CESR Best Execution under MiFID, May 2007, p22

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business practices. Attempts to create more formality and more certainty over these areas can only be beneficial.

Part of the challenge in this area has perhaps been a reduced amount of discussion and guidance as compared to the equities markets. This started with the CESR Q&A document which stated that "CESR ... has not addressed the question of how best execution applies to dealer markets"[6].

We note too that the FCA Thematic Review "focused on firms that were active in one or more of cash equities, exchange traded derivatives and CfDs" and "did not look at all asset classes which are within the scope of the best execution obligation"[7]. The industry has nonetheless been asked to re-review applicability and address gaps and weaknesses found across all asset classes.

Against this discussion we also note that there is an increase in the presence of agency brokers in FICC markets, and that this may itself lead to evolving practices and expectations between counterparties interacting with agency brokers on the one hand, and principal dealers on the other.

Further guidance and clarification should be established in some of these areas, and we see this Review as a good platform to launch such work.

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?

Following the above discussion, we believe that more detailed guidance should be established in this area. This could take the form of either market codes of practices or more detailed regulatory requirements. Codes of practices, if followed, would need to have regulatory support in order to ensure support for how these practices fit with existing and emerging European regulations.

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?

It is difficult to be prescriptive in FICC markets because of their diverse nature. Currently, suitability case studies are the best way of illuminating employees. This is a useful model and is similar to that of the English legal system, where precedence taken from case history informs judges' principles on forming law.

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?

We agree with this in principle. This could enable participants to better understand the risk associated with the specific products they are dealing with.

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?

Guidance in the form of market codes, supported by case studies, is helpful for the industry to establish better standards.

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

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[6] ditto, p4

[7] FCA Thematic Review on Best Execution and Payment for Order Flow (TR14/13) July 2014, p4

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authorities or an international standard setting body)? How to communicate it to trading teams? Whether, and how, to customise it for individual asset classes?

See response to Q30

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?

We have no comment to make on this question

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?

It is hard to be prescriptive in the area of financial products. The approval of new products needs to be cognitive of the suitability for certain types of customer, which in turn should take reference to set criteria that includes complexity and profitability,

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?

Whilst we are not in a position to comment on the role various factors have played in FICC market abuses, we would like to draw attention to the significant changes which have been made to the structure of remuneration in the market in the period during and after the abuses took place.

Regulation of remuneration in financial services has evolved dramatically in the period following the financial crisis of 2007/08. This was led by international organisations, regional bodies, national governments and regulators; nowhere more so than in the EU. Through the FSB's Principles for Sound Compensation Practices, Capital Requirements Directives III and IV and the UK's own Remuneration Code, market participants whose role has a material impact on the risk profile of their employer are subject to a highly regulated compensation structure, particularly in respect of their variable compensation. With mandatory requirements pertaining to the level and period of deferral, payment of bonuses in stock or other non-cash instruments, holding periods on non-cash payments and clawback provisions, market participants today have a far higher proportion of compensation at risk, for longer, than was previously the case.

This is particularly true for the 2014 performance year. In 2014 the new Regulatory Technical Standard on identifying staff subject to these rules significantly increased the in-scope population in all firms. In addition, the PRA's own requirements on clawback extended the at-risk period on variable remuneration to 7 years from the date of grant. Current proposals state that this could be extended to 10 years in certain circumstances.

As well as the requirements pertaining to compensation structures referred to above, regulation and regulatory scrutiny of the compensation process itself (e.g., governance, risk adjustment, performance assessment etc) has led to a far more disciplined process taking place before variable compensation awards are made.

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Compensation awarded under the current regime provides far less incentive for inappropriate risk taking than has previously been the case because of increased scrutiny as part of ex-ante risk adjustment processes and the risk of forfeiture and / or clawback once awards have been made.

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?

As noted above, significant progress has already been made by FICC firms in respect of performance measures and adjustments to remuneration over the last 4 to 5 years.

Whilst we appreciate the inherent challenges associated with the implementation of new regulation (particularly that drafted at the EU level) we would welcome the authorities' greater engagement with questions of interpretation and with the application of new rules to practical or unusual situations.

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?

We have no comment to make on this question

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?

Given that the promotion of a "level playing field" amongst firms is one of the key drivers behind the EU level regulation implemented in the UK , we would welcome any steps taken to extend measures to non-bank market participants.

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?

And

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?

We are supportive of measures to improve and enhance surveillance by both firms and regulators, and believe that the recent increased focus in this area has helped deliver more stable markets. There is, however, further work that can be done in this area. We believe that regulators have an important role in this, and are best placed to advise on further measures. It is regulators that have access to data across different market places, rather than the narrower data set each individual firm can access.

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Electronic surveillance is a good thing and can help flag and identify suspicious transactions. This should go hand in hand with developing an environment where whistle blowing or raising concerns is encouraged. Some aspects of surveillance are always going to require a human element.

With regard to electronic voice surveillance, while we are always supportive of new technologies that provide further tools for surveillance both firms and regulators, we feel that as the technology stands it is not at the level where mandatory roll out would be helpful. Further trials and demonstrations of effectiveness will be required before such surveillance can be implemented.

As always with regulation, it is important to acknowledge that there is not a 'one-size-fits-all' approach. Technology that may be effective, both in terms of cost and effectiveness, might not be scalable for all firms. Regulators need to be aware of this when introducing new regimes and requirements.

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)?

We believe that firms and regulators already have the tools to punish malpractice. It is consistency of application that is key to ensuring these processes and tools are effective.

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?

Firms already have the ability to highlight malpractice through the suspicious activity and transaction reporting regime and firms do sometimes bilaterally resolve issues which may not be reportable under the STR regime. It would be useful for the industry as a whole to receive more feedback from the authorities, where possible, on the outcome of STR reports and other reports made to the regulators and to receive further market intelligence where the regulator feels it is appropriate to disseminate. Currently there tends to be very little feedback after the submission of concerns to the regulators.

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?

We believe that regulators strikes the right balance with the UK wholesale FICC markets. As always, we support clear and consistent implementation of the rules that help deliver stability in the market.

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?

Transparency and access to data for the FCA will be greatly enhanced by the measures introduced in the MiFID II package recently agreed by the European Authorities. We believe that no further measures should be introduced until this regime and the impact of it has been fully assessed.

Regulatory-level penalties

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

Regulators already have the ability to take action against individuals and companies, including the ability to bring criminal proceedings. We believe that there should be a continued focus on personal accountability in order to ensure that all employees understand and take responsibility for stamping out the malpractice that has caused the industry so much damage in the past. Any punishments should take into account the intent of the action rather than imposing strict penalties on negligence or innocent wrongdoing.

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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?

We believe that a greater use of early intervention from regulators could be a useful tool, provided it is used thoughtfully and consistently. We do not believe that increased capital charges would be the correct method of enforcement in this area as it would be a broad brush to deal with a specific issue and would not necessarily have the desired impact.

We would note that other regulatory regimes have the power to implement bans on acting in specific markets for a period of time for persistent wrongdoing based on clearly established rules. This has proved to be effective in stamping out malpractice and may be a good template for the FCA to consider.

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

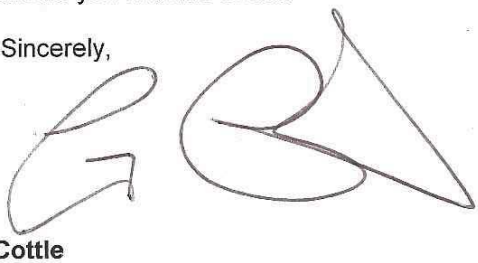
See response to Q46

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?

The FCA has the capability to levy personal fines and prevent people from operating in markets. These measures impose considerable burdens on individuals and we do not believe that further criminal sanctions are required in this area.

We hope our comments are helpful and would welcome the opportunity to discuss our views in more detail should you find this useful.

Yours Sincerely,



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