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Fair and Effective Markets Review October 2014

ACI – The Financial Markets Association (ACI FMA)

Official Feedback to the Fair & Effective Markets Review Consultation Document

Prepared on behalf of and by the ACI Management Board, ACI Steering Committee, ACI Foreign Exchange Committee, ACI Committee for Professionalism and the International Secretariat of ACI – The Financial Markets Association

This paper is the result of considered debate amongst the members of the ACI FMA appointed leadership and members, and is intended to provide our unbiased replies to the issues discussed in the FEMR Consultation on FICC, prepared by the FEMR team. The ACI FMA welcomes the opportunity to engage with the FEMR on this subject.

The ACI believes that the debate about the role of a variety of subjects within the FICC markets is a positive development, and should take place in a public forum. The benefits of transparency on the debate are numerous, and include the need for the public to understand the complexity of the markets, and the benefits that the broader economy derives from having fair and effective market in continuous operation. For this reason, the FEMR Consultation Document, and the responses from the various market participants to the document, will help the regulators, industry participants and the public to be better educated on the structure and uses of the fixed income, currency and commodity markets. The greater awareness that comes from this knowledge will assist the industry in assuring that best practices are followed.

The ACI FMA also appreciates the clarity with which the FEMR Consultation Document was written, and thanks the authors for the manner in which the document was prepared. The ACI FMA believes

that the Consultation Document accurately reflects the way in which the FX market functions. This unbiased reflection of the current state is helpful to the industry overall.

Importantly, the ACI welcomes the elevated importance that the Consultation Document places on the behaviour and ethical conduct of individual market participants. While we are of the opinion that the FICC markets enjoy a fundamentally sound structure, recent incidences of market abuse and conduct risk by a minority of market participants have brought disrepute upon the industry, as well as further damaging the overall trust the industry had with the public. Therefore, the FEMR Consultation Document reflects the need for cultural change. Further, it recognises that *individual* behaviour is to be held to the highest standards of ethical conduct, and that this needs to be embedded by *institutions* (their employers), and endorsed by the regulators. In this context, we would propose that the ACI FMA Model Code provides currently the most comprehensive, global best practices guideline and we are pleased that the FEMR consultation mentions our code of conduct.

Our response has been structured as follows:

- Executive summary:
- ACI's observations, issues and concerns with regard to the FEMR consultation
- ACI responses to the consultation questions

While members of ACI are engaged with financial trading or sales environment in the global wholesale financial markets, representing a variety of asset classes including foreign exchange, interest rate products and other securities, banknotes, precious metals and commodities and derivatives; the majority of the UK members are predominantly engaged in the FX markets. Therefore, unless otherwise specified, the ACI's responses to this consultation with regard to market microstructure, etc. apply to the FX markets. Additionally, while we acknowledge the comprehensive nature of the consultation questionnaire and will endeavour to respond accordingly, the ACI proposes to respond to the questions, which we believe have most pertinence for the FX asset class.

Section 1: Executive Summary

The ACI believes that the debate about the role of a variety of subjects within the FICC markets is a positive development, and should take place in a public forum. The benefits of transparency on the debate are numerous, and include the need for the public to understand the complexity of the markets, and the benefits that the broader economy derives from having fair and effective market in continuous operation. For this reason, the FEMR Consultation Document, and the responses from the various market participants to the document, will help the regulators, industry participants and the public to be better educated on the structure and uses of the fixed income, currency and commodity markets. The greater awareness that comes from this knowledge will assist the industry in assuring that best practices are followed.

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Document reflects the need for individual behaviour to be held to the highest standards of ethical conduct, and mentions the ACI Model Code.

KEY MESSAGE:

The ACI FMA is firmly of the belief that the Model Code should be adopted formally by the industry on both the "buy-side" and the "sell-side" and applied across the globe. As is stated by the FSB Consultative Document on Benchmarking, for codes of conduct to be effective they must be adhered to. The use of a single, globally recognised, industry-wide, unbiased code, that addresses the specific issues of the foreign exchange market will provide a tremendous amount of value to this problem. Disseminating the information and training staff on the uses of the sections of the Model Code is a minimum requirement for market participants. The ACI strongly endorses the application of the Model Code to the ethical and behavioural issues addressed in the FEMR Consultation Document.

The ACI FMA also reminds the reader that the Model Code makes a clear statement about the responsibilities of management and supervisors to ensure that codes of conduct are adhered to. Single-platform (company) and national/regional codes may sit alongside a global code, but there should be few (if any) differences in the application of these codes on market practice. Any differences increase the risk of ethical arbitrage amongst market participants, and give rise to the issues about which the Consultation Document was written. For this to be effective, the regulators need to agree to the terms, understand both the code's guidelines and how they are applied, and allow individuals and institutions to be confident that following these guidelines will be accepted as appropriate.

Section 2: Issues and Concerns

1) A number of regulatory initiatives exist and/or are being revised (MIFID I,II,MAR[1]/MAD[2], DFA[3]), which have sought to ensure market transparency, investor protection, to promote competition, prevent market abuse (insider information disclosure), improve business conduct (customer miss–selling) and identify/mitigate/eradicate conduct risk

While being supportive of the consultation objectives, the ACI recognises the potential impacts and burdens (legal, technical, operational, etc.) of compliance with the on-going regulatory and legislative reform on FX market participants. Therefore, the ACI would advocate prudence and consideration regarding the introduction of further regulation. Regulators need to allow the full impact of the on-going regulatory initiatives/revisions and the ensuing changes to be absorbed by the global markets, in order to evaluate whether further intervention is necessary to capture hitherto unidentified risks and to prevent the emergence of new systemic risks and/or the disruption of existing, functioning markets and liquidity.

Cultural Change / Conduct Risk

The recent observed market abuses were fostered by cultural failures or misinterpretation. Culture is an essential organisational focus and the FCA has stated the following elements as key drivers for this:

- Setting the tone from the top;
- Translating this into easily understood business practices; and

- Supporting the right behaviours through performance management, employee development, and reinforcing through reward programmes

The industry must support the Regulators to drive cultural change and in order to do this, institutional executive management needs to:

- Initiate a business wide directive to develop and encourage **a culture of trust and empowerment that rewards employees who apply judgment, empathy and insight to actively deliver these outcomes.**
- Operate an ethical and responsible customer-centric business with integrity and accountability at all levels
- Align business strategy and outcomes to this new model
- Put a front office control framework with protocols and procedures in place, including education programmes, personal development and evaluation measurement and the commitment to an individually accountable, **global code of conduct** so that this cultural conviction is not disregarded in either the process of business execution or future planning
- Create behaviour change programmes that ensure that leaders 'walk the walk' and demonstrate the change in tone from the top

Section 3:

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?

For markets to be 'fair and effective', there must be a willingness on all sides to engage in economic activity without concerns on the part of either party that the role they are performing is unduly prejudiced. Buyers must have choice of seller, and be able to access prices without being constrained by market structure or regulation that channels decision-making in an uncommercial manner. Price-takers must be able to access price-makers in an unrestricted fashion. Both sides of the transaction must believe that they are receiving value for the activity they undertake. Thus, a price-taker must not be forced to use a provider that biases decisions in a way that prevents the price-taker from making independent choice. A price-maker must not be forced to make a price that he/she doesn't want to make, unless that choice is part of a bigger picture of the price-makers choosing. (For example, a bank might price a client's business at a tighter spread than he/she might otherwise do if the price-maker is focussed on league-tables, share of client wallet, or pursuing a particular strategy.

Note that this willingness to transact changes over time, as the evolution of the price-taker/price-maker relationship is impacted by any one of a number of factors. For example, advances in technology or the changes in credit allocation have shifted the interbank voice market to electronic price-discovery, and the classic client-to-bank via bilateral trading lines (credit) has broadened as traditional mechanisms are adjusted through increased competition. What was once a common

practice may become far less common, and structures and behaviours that that were once thought impossible (such as client-to-client trading, or disintermediation, becomes more accepted.

This evolution takes place over time, but in open competition, and investment in technology or trading regimes must retain a risk/reward element to be effective. Mandated or imposed changes bring unwanted and unforeseen consequences. The concept of choice must remain.

As each market participant has the duty to act in their own self-interest to protect themselves, they should be free to act in a way that achieves those goals, over time. Strategic choices are made by company Boards, with the associated investments and management time deployed to achieve strategic aims. For example, a bank may choose to participate in the 4 pm WMR fix on behalf of clients, without charging a fee, if there is a belief that the client will provide an opportunity to reward the bank in an appropriate fashion. The bank may, alternatively, decide to decline to participate in the execution of the client's business without a fee. Similarly, a client may prefer to engage in the certainty of fee by dealing with a bank on an agency basis, or the client may be prepared to pay a spread to execute his or her business, understanding full well that the bank providing the price-making is taking a proprietary risk in so doing. One method is not necessarily preferable to another. What matters is that both sides of the transaction are achieving their aims openly and in full knowledge of their activity, and that it is transacted fairly (for example, not in breach of regulations on collusion, sharing of material on-public information, etc).

As markets evolve, definitions of fairness may change, as will requirements for transparency, openness and equality. Particular attention must be paid to the methods of sourcing liquidity, bi-lateral and multi-lateral credit facilities, price-making systems (i.e. electronic brokers/exchanges) and other components of the FICC market that make it work effectively today.

The ACI would propose that given the global nature of the FICC markets, informed discussion with other international Regulators and Legislators to ascertain their interpretation and definition of 'fair and effective' within the financial markets context would be judicious.

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?

Q2a) The six themes can be put in priority sequence as follows (with highest contributor first):

1. Responsibilities and incentives
2. Standards of market practice
3. Surveillance and penalties
4. Competition and market discipline

5. Benchmarks
6. Market microstructure

1. Responsibilities and incentives

Responsibilities and incentives are beyond doubt the most important component. Enough has been written about the market's competitive nature, and the requirement to pay appropriately to secure the services of the best contributors to a team. This is fair, as it is in other business professions, where expertise and ability are rewarded, AS LONG AS THERE IS APPROPRIATE SYMETRY BETWEEN THE RISK AND THE REWARD. However, it is the responsibility of those providing the incentives over an appropriate period of time, including the individual, line managers, senior managers and the Board of Directors, to ensure that all levels within the company are behaving responsibly, and that the roles of all levels within the company are ensuring the incentives are in alignment with fair market practice.

Where we have witnessed a breakdown in ethical behaviour it is often a coupling of individuals (or teams) seeking to maximise their individual gain, and acting without the appropriate responsible supervision, or without adequate systems and controls in place to ensure that behaviours were remaining appropriate. Some of the incentives provided were based upon a single objective (such as monthly revenue targets) and did not account for other factors contributing to the success of a business, such as ethical behaviour, treating clients fairly, acting according to contracts, and the like.

The ACI Model Code is clear on the responsibilities and incentives in this context.

2. Standards of market practice

Most of the standards practiced in the market are appropriate, and most of the individuals were operating on what they believe to be the right practice for the time. Where this has fallen short, market practitioners would agree, there is a an important need for these practices to be appropriately illustrated in order that all market practitioners understand and have best practice confirmed to them. Similarly, it is important for management, members of compliance, legal, audit, human resources and other connected areas also understand and agree what is the right standard of market practice. This will avoid confusion and help ensure a fair and effective market. Note that these standards should be visible to all sides of a transaction, and that standards can be agreed by both price-takers and price-makers in an open dialogue.

The ACI Model Code is the clear global leader in providing standards of market practice.

3. Surveillance and penalties

For a period of time, as incentives grew with the size of the business, insufficient attention was paid to the need to have adequate training, review, systems and controls. Management did not act in accordance with their responsibilities. As such, they rewarded the results of the activity they supervised with paying sufficient attention to understanding how and why business was being transacted. Discovery of inadequate procedures or behaviours was not met with consequence, and no penalties for poor behaviour were awarded.

The ACI Model Code is quite clear on the obligations of supervisors to have proper surveillance of their staff, and for appropriate penalties to be in place.

4. Competition and market discipline

Competition and market discipline must be maintained. Competitors often maintain discipline by operating at arm's length from each other, and provide clients a choice of opportunity. Should competitors act together, clients no longer have a real choice. Collusion must be eliminated.

There have been concerns by some about the concentration of the strong majority of business into a smaller number of powerful institutions. However, there remains a great deal of choice as to service and credit provider for end-user clients, and the market continues to evolve. Any broader concerns about Too Big to Fail, G-SIFI or GSIB should be dealt with via other processes than a review of the FICC markets, where access to pricing via credit lines, for example, remains open and competitive.

5. Benchmarks

Benchmarks are necessary, and helpful, especially in 24-hour, global markets such as the markets of FICC. The FSB study reviewed the aspects of benchmarks and behaviour; the statistical aspect of the benchmarks appears sufficiently robust, but individual behaviours to operate in an inappropriate way at the benchmark fixes have been called in to question. This must be dealt with separately than with the benchmarks themselves.

6. Market microstructure

The process of change in the market micro-structure is already sufficiently underway, and has always been in evolution; investments have been made, to varying degrees of success, in early forms of electronic trading that now work extremely well in FX, but are still being adjusted to commercial success in fixed income. This microstructure adjustment should be allowed to continue in an open and competitive manner.

Q2b) With regard to areas of vulnerability that are not identified in the table, the ACI FMA would propose the following:

The FX market is the most liquid, truly global market (see Q4) and as such the ACI FMA does operate and encourage compliance with the ACI Model Code, as it is a global code.

Nevertheless, there are areas of vulnerability, which, despite the train of current or pending regulation (MiFID I & II, EU Benchmark Regulation) to underpin and ensure fair and effective market environments going forward, are a cause for concern. There is a need for international co-operation and co-ordination of regulatory reform as a lack of cross border regulatory co-operation, inconsistent interpretation and/or conflicting rulemaking in diverse jurisdictions will prove burdensome and costly in implementation for market participants and/or can foster regulatory arbitrage.

Barrier and digital options

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

The risks brought by the contracting of barrier or digital options are distinct in their precise detail, but pose no threat to the market that requires regulation. The existence of barrier options at various levels creates a potential market trading dynamic due to hedging requirements of the market maker that may create temporarily higher levels of volatility similar to that to a market with lessened market liquidity.

The critical disclosure for barrier or digital options is that the legal contracts between the contracting parties clearly state that both parties understand the nature of these options, especially around the potential challenge that the hedging requirement may cause the bank to act in the interests of the bank and against the client at a critical juncture. This must be transparent, and the potential conflict managed appropriately.

Trading practices between the two counterparties should be based on a mutual understanding of the risks both take and this should be reflected in the underlying documentation. Hedging practices around barrier options should be governed by a global code of conduct that applies to both parties of the transaction. In the Model Code the most relevant section is **Appendix ONE - General Risk Management Principles for a Dealing Business**

In particular the professional dealer must not only understand and manage the market risk pertaining to a trading position, but should also be aware of the credit, legal, liquidity, regulatory, reputational and operational risks relating to the business. Given the grey area surrounding specifically barrier/digital options more detailed guidance could be given in codes of conduct to more precisely address the balance between fair and prudent hedging and abusive behaviour; and the two responsibilities a dealer has to the client and that of protecting his firm's market risk. See also the answer to Q.12.

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?

In fixed income: a lack of homogeneity of assets makes "electronification" of trading a much more difficult undertaking than in FX. This complexity reflects the nature of the cash flows of fixed income products, and the precise capital and liquidity requirements of these instruments. Fixed income instruments are issued with these precise cash flow and capital specificities for a reason, and the

standardisation of these factors may impede the requirements of the issuing entity. For that reason, these instruments should not be regulated differently (i.e. they issuers should not be required to confirm to a set schedule simply for the goal of ease of e-trading).
However, issuers may well find liquidity benefits of adopting a standardised approach to their fixed instruments, and should be able to make decisions on adopting any suggested common parameters if they see fit to do so. As with all other forms of micro-structure evolution, companies that make the right investments in the technology of the future will be rewarded, while others may make an effort and meet less success. This has been taking place for years already, without causing challenges to the markets' fairness or effectiveness. Forced homogeneity of microstructure may create a number of unforeseen consequences.

With regard to the FX market: The global daily volume of the foreign exchange (FX) markets according to the Bank for International Settlements[(X)] preliminary global results from the 2013 Triennial Central Bank Survey of Foreign Exchange and OTC Derivatives Markets Activity show that trading in foreign exchange markets averaged $5.3 trillion per day in April 2013. The transmission and exchange of currency is a fundamental financial activity that underpins the world's economic and commercial system. The specific reasons behind each FX transaction are. However, the principal drivers behind FX activity can be regarded as:

- Commercial - payment for goods and services
- FDI - to effect foreign direct investment
- Derived from other financial markets activity i.e. purchase of foreign currency denominated assets – bonds or equities
- Hedging of portfolio asset (currency) risk
- Direct investment in currencies

The FX market is primarily an OTC market, which is de-centralised and geographically dispersed by nature with no dominant market venue. Transactions are bi-lateral, with prices discovered, indicated, quoted and trades executed by/on a variety of trading institutions, venues and electronic platforms – single dealer, multi dealer, retail and internet providers. Buy-side counterparties have access to a broad range of currency pair, maturities and counterparties; therefore enjoy substantial transparency in liquid markets. The BIS Quarterly Review(*ref), December 2013 reported that electronic trading was the preferred trading channel of market participants, with a share above 50% for all customer segments and this is available for all instruments and investors across the globe. This report suggested that Spot is the segment with by far the highest fraction of trades conducted electronically, at 64%. Some market reporters suggest that as much as 95% of all spot transactions could in fact be electronic. These developments, combined with the pre and post trade transparency requirements under MiFID II, DFA etc. should continue to facilitate increased transparency and, ergo, enhance customer centric fairness and market efficiency. Nevertheless, the liquidity provided by market makers is crucial for the stable, fair and effective operation of markets.

As noted in the BIS Quarterly Review(*ref), December 2013 ,due to, in part, the emergence of electronic trading platforms, the once clear-cut two-tier structure of the market, with separate inter-dealer and customer segments, no longer exists. At the same time, the plethora of channels over which the different market participants can interconnect as well as STP has increased significantly, facilitating reduced 'price discovery' and trading costs. This has enabled counterparties, according to the BIS report, who were previously financial customers to become liquidity providers alongside dealers.

However, recent events, (e.g. the removal by the SNB of the EUR/CHF floor/cap) have demonstrated **how over-reliance on electronic trading, whether mandated by regulation or not**, can, in an

unexpected market environment, facilitate a liquidity squeeze/abyss as there may be no willingness for market liquidity provision as would have previously existed in a voice only environment. Therefore, in this situation, the predominance of 'one' market structure (e-trading) and the demise of traditional bi-lateral voice trading has diminished the fairness and effectiveness of the FX (spot) market.

With regard to barriers to market access/exit, currently the ESMA proposed mandatory CCP clearing of FXOs and NDFs and the uncertainty with regard to the derivative or non-derivative status of FX forwards, may, in the ACI's opinion, cause such barriers and impose additional legal, operational, financial (direct and indirect) and systemic burdens for some market participants.

Q4 Where there are deficiencies, will recent or in-train regulatory or technological changes improve the situation, or are further steps needed?

The ACI would advocate prudence and consideration regarding any further regulatory intervention for the FX market microstructure until any in-train regulatory or technological changes have been introduced, absorbed, harmonised and evaluated to prevent operational inconsistency, the emergence of new systemic risks and any potential impact on market liquidity. ACI believes that commercially driven innovation will and should continue, provided that such innovation does not lead to, or stem from, unethical behaviours.

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?

Please see the comments re: FX electronic trading in Q4.

Additionally, with specific reference to 'Stop loss orders' execution post the SNB removal of the EUR/CHF peg, these orders have been automatically generated on the various e-trading platforms, matched and confirmed by settlement systems without the institutions concerned necessarily having the opportunity to cover their risk. We have observed that, due to the unprecedented circumstances, customers have experienced some very different treatment at the hands of their banks/brokers. This has varied from the banks/brokers honouring the generated trade rates and absorbing the losses vs. institutions revisiting and proposing to reset the trade rates at the customer's cost.

The ACI Model Code (MC) contains a clause about stop losses on e-platforms, it reads as follows:

"Additional attention should be paid where e-trading platforms automatically execute stop-loss orders. In accepting these orders, whilst an institution assumes an obligation to make every reasonable effort to execute the order promptly, there is no guarantee of fixed price execution to the counterparty unless otherwise agreed by both parties in writing."

Traditionally, the MC proposes the following in the "Dealing Through Brokers" section, which states, "Dealers should regard themselves as bound to a deal once the price and any other key commercial terms have been agreed."

This could conceivably be transferred to the electronic market, but then the Code goes onto state,

"However, holding voice brokers unreasonably to a price is viewed as unprofessional and should be discouraged by management."

The ACI would encourage clarity from the Regulators with regard to market behaviour in such instances, **where the interpretation of clauses in legal contracts (legal standpoint) may contradict what would be regarded as best market/customer centric practice.**

Nevertheless, there are benefits to some participants in having a greater use of electronic trading, and those markets participants should find their own solutions as fits their needs. Financial institutions that provide these improved services will see clients gravitate toward them over time. However, we have seen new forms of technology provide these benefits already arriving to the market, and in a competitive form: witness the rise of the CCPs. A CCP is able to clear and provide a plethora of credit and collateral benefits to participants in the clearing house across a number of markets, and competition in this market is genuine. There are some new risks emerging, such as concentration risks and default fund structures are being reviewed. These entities are part of the market evolution, and will likely continue to grow in importance.

Forcing global, non-standardised asset classes such as FX or fixed income onto an exchange can bring risks, yet volumes on these exchanges are growing. This should be left to the market forces between the institutional offering, and end-user/client requirements.

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

Standardisation is potentially possible, provided that it doesn't have a forced impact on specific liquidity or capital requirements of the issuer. Should there be liquidity benefits to enhanced trading volumes that out-weigh any specific requirements for capital or the timing of cash-flows, companies issuing debt may move toward these common attributes.

This can be brought about by having commercially available solutions that enhance these trading and transparency benefits. Investments in such technology are being made, with some likely to succeed. Standards might be set by a non-partisan group of market participants, but should be left to the industry to develop further. This will evolve over time.

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?

Auction mechanisms are already available should they be desired, but are not always employed. Standards of behaviour or codes of conduct should be agreed upon to prevent manipulation of collusion in primary debt markets, with clear guidelines issued on reciprocity and other practices. However, there are few if any areas where change should be mandated.

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?***

Internalisation in and of itself is not perceived to create risks as long as it is conducted within the existing General Principles contained in the ACI Model Code.

Last look can represent a risk to foreign exchange markets if its use is inappropriate and clients are not adequately informed of its application and the consequences to their trading. In particular it is important that provision of "last look" liquidity does not create a false impression of market levels or depth. Under no circumstances should orders with last look be placed for the purpose of price discovery and with no intention to trade. It should only be used in order to mitigate technological anomalies and latencies when showing firm prices to clients. Having been fully apprised of the benefits to them, customers should be in a position to decide to trade or not using "last look" pricing, in line with the customer's own requirements and execution style. Customer preference can vary – some might prefer as tight a price as possible, accepting a higher rejection rate through 'last look,' whilst others might prefer certainty of execution at a different price. When a platform uses last look pricing from its liquidity providers this must be transparent to the clients. Furthermore the application must be fair. Use of electronic algorithms solely to accept trades that are favourable to the bank and reject non-favourable deals, when the criteria for assessing are equal, should be avoided.

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

The ACI would refer to:

http://www.financialstabilityboard.org/2014/09

And

ACI FMA's response to the FSB consultation

http://www.financialstabilityboard.org/wp-content/uploads/c_140819a.pdf

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

To a large extent, OTC commodity derivatives behave in the same manner as OTX FX markets, and should be able to benefit from the same transparency requirements.

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?

Although there are initiatives such as the IOSCO Task Force on Cross Border Regulation (Consultation report of 'IOSCO Cross-Border Regulation Consultation Paper' November, 2014[X]), which is a very necessary endeavour, as well as other national and international programmes; more discussion, cohesion and harmonisation between regulatory authorities on both an intra and inter-continental basis is required, without abrogation of individual responsibilities, in order to facilitate equitable, fair, effective and efficient markets.

In particular, we would draw the regulators attention to the following high level examples, which are not exclusive. However, where there have been inconsistencies in scope, interpretation and

application of regulatory objectives, which in turn have fostered the potential for either increased technological, operational, legal and costs burdens on market participants or alternatively, facilitated regulatory arbitrage.

- DFA vs EMIR: equivalence requirements on extraterritoriality, clearing requirements, trade reporting
- DFA vs EMIR: treatment of FX forwards, interpretation under EMIR as a derivative
- DFA Swap Execution Facility (SEF) requirements
- Financial Transaction Tax
- Bank Structure Reform

The ACI believes that it would be prudent if any proposed standards embraced the flexibility to avoid any potential for regulatory arbitrage through conflicting regulation.

a. Observance and compatibility with market-driven and industry-led practices and existing regulatory frameworks, which have been identified as supporting appropriately established risk mitigation standards i.e. recognised best practice
b. Awareness and observance of legal and regulatory differences and approaches by national jurisdictions, especially where these are justified by country-specific objectives.

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?

Confidentiality is essential for the preservation of a reputable, ethical and honest market place. The ACI Model Code insists that firms must have in place clearly documented policies and procedures, and strong systems and controls, to manage confidential information within the dealing environment and other areas of the firm which may obtain such information. Any breaches to this should be investigated immediately according to a properly documented procedure.

Firms with a fiduciary interest in certain trades should disclose this information to the counterparty to avoid or manage any potential conflict of interests.

Dealers should at all times, act in the best interest of their customers and disclose any potential conflict of interests to the customer where necessary.

When disclosure of specific conflicts of interest is required, the disclosure shall clearly state the arrangements that have been established to manage that conflict.

The description of the conflict of interest must explain the general nature of the conflicts of interest, as well as the risks to the client that might arise as a result of the conflict and the action undertaken to mitigate these risks; in sufficient detail to enable that client to make an informed decision regarding the transaction.

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?

This is already addressed under MIFID 1 (revision MiFID II) as well as under MAR – Code of Market Conduct/MAD. In the FSB consultation with regard to the WM FIX (Refer #4), several recommendations have been proposed by the FSB to ensure that there are clear, global guidelines with regard to communication and mediums of communication - appropriate and inappropriate, among market participants, from both within and between market making counterparties.

Additionally, market participants must adopt a 'duty of care/know your customer/client categorisation or suitability/product appropriateness approach' in order to comply with business conduct standards and facilitate an appropriate, fair, clear and not-misleading dissemination of information to their customers.

Physical barriers could be impractical and cost prohibitive for smaller banks that potentially could lead to more concentration risk.

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.

The FX market is the most liquid market globally. Fairness and effective competition is promoted through market forces and circumstances i.e. prevailing regulatory environment, liquidity/convertibility, supply & demand. Regulation under EMIR/MIFID with regard to trade and data reporting should support transparency and effectiveness.

As mentioned under Q4, the BIS Quarterly Review(*ref), December 2013 reported that electronic trading was the preferred trading channel of FX market participants, with a share above 50% for all customer segments and this is available for all instruments and investors across the globe. This report suggested that Spot is the segment with by far the highest fraction of trades conducted electronically, at 64%. Some market reporters suggest that as much as 95% of all spot transactions could in fact be electronic. Price feeds, pricing, liquidity and transactions data from a broad array of sources e.g. MBPs, SBPs, SEFs, and OTFs in a wide range of currency pairs and tenors are available to customers under circumstances of normal liquidity.

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?

The FX markets, as stated, generally enjoy effective competition.

With regard to the FX WMR Fixing we refer the Regulators to Q9.

Where there are barriers to entry in local (emerging non EU) FICC markets due to regulation, non – convertibility or geo-political tensions, there are market-driven and industry-led practices, platforms and products (NDFs) and existing regulatory frameworks, which have been identified as supporting appropriately established risk mitigation standards i.e. recognised best practice and facilitating liquidity. These all contribute to a more effective framework.

Additionally, potential mandatory clearing of NDFs and FX Options via CCPs under MiFID II, as well as trade data and reporting requirements should enhance transparency and competitiveness. With respect to the NDF Clearing initiative, the ACI would encourage that the standardisation of the NDF market has increased as a result of industry initiatives led by associations such as the Emerging Markets Trade Association ("EMTA") and the International Swaps and Derivatives Association ("ISDA")". Existing frameworks should be adopted without modification by transacting parties, including CCPs, for any FX NDF contract, which is subject to mandatory clearing. In the event of a modification, the standardisation developed by the industry for a given currency pair would be compromised and may result in new risks for market participants and; therefore, a potentially less effective, competitive market environment.

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 would refer to the (potential) impact of conflicting cross border regulation .i .e. DFA Title VI impact of Volker Rule, Title VII SEF trading requirements, margin requirements for non-centrally cleared trades, potential different treatment of FX (forwards) as derivatives under EMIR vs DFA.

Regulatory discrepancies foster confusion and potential for regulatory arbitrage, the ACI would advocate, where possible, cross-border regulatory co-operation.

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?

MiFID I provided an earlier guidance for enhanced market discipline. Requirements for compliance under MIFID II and MAR introduce increased surveillance and enforcement measure for market participants. It will be incumbent on all market participants to demonstrate/evidence compliance with these regulatory and legislative requirements. There are existing industry led initiatives/ frameworks, which promote efficient market practices by encouraging high standards of conduct and professionalism, the ACI Model Code is an example of an industry initiative.

The ACI Model Code, which is mentioned in the consultation, is wide ranging, encompassing the over-the-counter markets and instruments traded by international bank treasury and capital markets departments. It is the only global code, which is written by a group of professionals and market practitioners for the use of market practitioners. It provides guidance on practical matters as well as giving guidance on ethical and moral issues. It demands that individuals be accountable for their behaviour, but also places emphasis on supervisory responsibility and obligation. As such, it is fully aligned with the requirements of various regulators. Importantly, it is in use around the world by a number of central bankers and regulators, as well as by ACI members in their thousands. It is

referenced in the "Global Preamble" by all central bank FX Committees, or is used directly by them as is the case across much of Europe and Africa, for example

Please refer to Q 28-33 (Standards of Market practice) for more in-depth responses. Additionally we would refer to our answer to Q2 with regard to the importance of individual accountability at every level in the company and of company culture.

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

The results of the FCA Wholesale Sector Competition Review 2014 is still outstanding and the ACI proposes that it would be prudent to await publication of the findings and evaluate their impact before pre-maturely initiating any additional assessment in the relevant markets.

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

The ACI expresses its support for the regulatory measures being implemented in the FICC markets to promote competition and markets discipline. However, given the number of initiatives, some of which are yet to be implemented (MIFID II), the ACI would express concern that the impact of these initiatives on markets operations from a legal, technical and systemic risk standpoint needs to be analysed and evaluated before any additional regulatory reforms are considered and/or introduced.

Not all asset classes operate in truly global markets; however, the FX market does. Therefore, it is imperative that cross-border and cross asset class regulatory initiatives to promote competition and market discipline i.e. surveillance and enforcement are consistent and complimentary to facilitate orderly local and international markets and exemplary business conduct standards and to prevent regulatory arbitrage and/or disruption. Single-platform (company) and national/regional codes may sit alongside a global code, but there should be few (if any) differences in the application of these codes on market practice. We believe that the ACI Model Code as part of a Business Conduct framework provides a solid foundation for individual, institutional and global compliance. The ACI Model Code may assist the entire wholesale financial services to improve its behaviour and embed the cultural norms that may be expected of financial markets professionals.

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?

Global financial markets are, of nature, places of innovation, which have over generations thrived or failed through competition. With reference to the recent misconduct cases and to the ACI's response under Q36, it may be purported that there was either a lack of rigorous awareness and understanding of the existing competition framework on the part of individuals or at institutional level (or both)

The Regulators are consulting with the industry regarding:

- regulatory initiatives to improve governance (surveillance and supervision) and incentives
- regulatory action i.e. fines and punitive measures

- industry and firm-wide initiatives to align market conduct with improved governance and appropriate incentives

The ACI believes that this consultation and the successful implementation of a 'Fair and effective markets' framework is imperative to ensure well-functioning, fair, effective and regulated markets.

Benchmarks

Q.21 to 26.

(The Model Code re Benchmarks).

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

There are a number of initiatives, both domestic and international, which are currently being proposed, evaluated, and introduced to improve the robustness of benchmarks. Therein, lays the ACI's concern. As with much of the 'train' of impeding regulatory initiatives, we would propose the need for international regulatory co-ordination to facilitate a consistency of approach to prevent fragmentation, inconsistency and systemic instability.

While the ACI supports the principles espoused in IOSCO's Principles for Financial Market Benchmarks in July 2013, which have provided global framework for the industry, we have in particular concerns regarding the proposed EU benchmark regulation and its potential impact on the range of indices that would be available. EU supervised entities (broadly, credit institutions, investment firms, insurers and reinsurers, UCITS, AIFMs, CCPs, trade repositories and administrators) will only be permitted to use benchmarks provided by authorised EU administrators or non- EU administrators registered with ESMA. This may result in a significant restriction in the use of benchmarks, which are in widespread use today and could require supervised entities to sell existing holdings or to modify existing contracts.

Additionally, the proposal that fund managers may be deemed benchmark administrators if, in order to accurately benchmark, they have to use a blend of two or more publicly available indices, is not appropriate.

With regard to the UK benchmarks, under the Regulator's the Fair and Effective Markets Review's recommendations on financial benchmarks (December, 2014), the following 7 benchmarks are determined as major benchmarks

- Sterling Overnight Index Average (SONIA)
- Repurchase Overnight Index Average (RONIA)
- WM/Reuters (WMR) 4pm London Closing Spot Rate
- ISDAFIX
- London Gold Fixing benchmark
- LMBA Silver Price
- ICE Brent Index

These are deemed both a "specified benchmark" and a "relevant benchmark" under the current UK regulatory framework. However, the regulatory framework will apply to the 7 benchmarks in

different ways, reflecting the differences in their construction. The UK regulators have introduced a robust framework, which will improve resilience against attempted manipulation and should reduce risk of misconduct and associated fines and/or litigation risk.

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

The UK Fair and Effective Markets Review's recommendations on financial benchmarks (December, 2014) proposes that the imposed regulatory framework should:

- increase the credibility and integrity of these benchmarks among authorities, market participants and the public
- create greater confidence in financial markets

through increased governance and regulatory oversight. Asset managers and investors rely on the benchmarks to provide transparency in the measurement of asset investment performance. Therefore, it is not a question of trying to reduce the reliance of asset managers or other investors on benchmarks, rather it is a matter providing these clients with a fair, effective, client centric, appropriate benchmarking environment.

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

The IOSCO Principles for Financial Benchmarks provides a strong foundation framework to underpin market assurance regarding benchmarks. The UK regulators Regulator's the Fair and Effective Markets Review's recommendations on financial benchmarks (December, 2014) proposes that the imposed regulatory framework should additionally (see Q22):

- improve resilience against attempted manipulation
- reduce risk of misconduct and associated fines and/or litigation risk
- decrease the likelihood of cessation of these key benchmarks
- increase the credibility and integrity of these benchmarks among authorities, market participants and the public
- create greater confidence in financial markets
- increase governance and regulatory oversight.

As previously mentioned, the need for international regulatory co-operation to prevent conflicting regional reforms, proposals and rules is advocated to prevent lack of consistency in interpretation.

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

Yes. Formal and informal involvement/engagement of industry practitioners and practitioner panels in regulator led consultations is always advisable. This is especially prudent prior to the creation or adoption of any proposed regulation to avoid the introduction of inconsistent measures, which in turn might fuel additional risks and market instability. The ACI has been greatly encouraged by the involvement of the FX Expert Group in this consultation.

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

As per the response to Q23, we would advocate international regulatory co-operation to prevent conflicting regional reforms, proposals and rules to ensure consistency in interpretation. The establishment of a peer Expert Group and the introduction of an internationally co-ordinated implementation plan would be advisable.

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

The ACI would propose that proven compliance with the IOSCO Principles for Financial Benchmarks should be the basis of recognition for benchmarks administered in other jurisdictions.

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?

Excerpts from the ACI Model Code on: FX Benchmark Orders

Execution of Orders

- Dealers should not disclose any pre-trade information including the direction and size of the trade.
- They should have a best execution policy in place to ensure that orders are on terms that are most favourable to the customer.
- Dealers should at all times, act in the best interest of their customers and disclose any potential conflict of interests to the customer where necessary.

Treatment of FX Benchmark Orders

- Dealers should not by collusion or otherwise inappropriate sharing of information, influence the exchange rate.
- Dealers should not intentionally influence the fixings in an attempt to benefit from the fixing itself if they don't have customer related flows at the underlying fixing.

- Dealers and sales persons should inform clients in advance about external factors that could affect the benchmar*k rate, for example, macro data, illiquid market conditions, and any other relevant event.*

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 agree that the list in the question contains uncertainties that have been raised with the ACI's Committee for Professionalism. We will be communicating directly with the FEMR process how the latest 2015 Model Code addresses these, and what further updates will be made were gaps between market uncertainty and the Model Code exist. The Model Code sets out the need for clarity as to the capacity (agent or principal) a firm is acting when providing aggregated pricing as well as detailed guidance with regard to front running.

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?

We see the provision of a Global Code of Conduct such as the ACI Model Code as essential going forward. Further regulation risks unintended consequences and may not produce a level playing field. Education is key to the effectiveness of any code of conduct, and this must be approachable and delivered in a user friendly manner (web based for example), and must be global in nature. It is essential this is backed up by self-certification and auditable completion of the attendant education required for participants to be current.

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

The development of a single Global Code of Conduct, with annexes to cover the various OTC asset classes and regional variations where appropriate, delivered with online education and self-certification would encourage the development of software by vendors that would enable global firms to ensure employees are current and complying with the code of conduct. Already a majority of professional training firms for FX use the Model Code for the sections regarding ethics, conduct and best practice in their courses. Further development of a single code adjusted for use by financial

institutions and corporates would encourage both parties to a trade to conduct themselves in the appropriate manner.

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

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

Yes. ACI already provides a comprehensive suite of examinations including a stand-alone exam on the Model Code. This should form a minimum requirement and be followed up by continual professional development – see our answer to Q.30 & 32.

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

The aim of the ACI Model Code is to promote fair and efficient market practices by encouraging high standards of conduct and professionalism. The Model Code has been compiled and is regularly updated in response to an urgent and ongoing international need amongst participants operating in the OTC markets. With its long history spanning back to 1975 it has served as practical study material for examination candidates. The Model Code has a specific ACI examination which is fully supported by online training and a programme of self-certified Continual Professional Development. Had its use been more universally adopted in more recent times with appropriate investment by firms in the educative process many of the recent problems could have been avoided.

Q33: How would any code tackle the design issues discussed in Section 5.4.3, i.e.: how to ensure it can be made sustainable given industry innovation over time? How to differentiate it from existing codes? How to give it teeth (in particular through endorsement by regulatory authorities or an international standard setting body)? How to communicate it to trading teams? Whether, and how, to customise it for individual asset classes?

Should the scope of regulation be extended?

The ACI has recently invested significant resources to enable the Model Code to be updated at a minimum biannually. With the introduction of the education initiatives this will be further enhanced by an online tool allowing industry participants to submit scenarios to the Committee for Professionalism for them to inform and point to the relative section of the Model Code. This will allow for a continual reassessment and periodic update for the Model Code to stay current. In addition the Committee for professionalism operates an arbitration service details of which are given in the Model Code. The committee would welcome input and the opportunity to work with other committee's in maintaining a single global code. If official endorsement was forthcoming the

ACI would be happy for a global regulatory body to function as a supervisory board in the production of the Model Code. A single code endorsed by both the industry and the supervisors would make the Model Code sustainable and with "teeth". A long stated aim of the ACI has been to produce a code with a set of ethics and market conduct rules that apply across OTC markets with appendices to deal with asset class and regional variations/requirements. It has also been resolved to produce the code for three constituencies – banks, financial institutions and corporates so that all participants to a deal can be covered by a common set of principles.

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?

The ACI is of the opinion that the FCA Principles for Businesses should be generally applicable. Nevertheless, there is a required differentiation with regard to the level of customer care and protection afforded on transactions between Eligible Counterparties and transactions between Eligible counterparties and retail customers. MIFID II client classification regime provides guidance on this to ensure that institutions understand their obligations regarding client protection vs product suitability.

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?

Of the products included in the FX asset class, FX spot is not included in the G20 regulation. While being supportive of the 2009 G20 Pittsburgh Summit objectives, the ACI believes that it would be inappropriate for this product to be included under the scope of current and impending regulatory regimes (DFA, MIFID II, EMIR, etc). Our reasoning is that the requirements for reporting, clearing, collateralisation, price transparency are unnecessary and would be operationally and technologically burdensome, as well as potentially disruptive to a market which supports the global payment system and has an existing and effective settlement system (CLS).

Additionally, as reported in the Bank of England FXJSC paper on the Foreign Exchange Market (Bank of England FXJSC Paper on the Foreign Exchange markets – September 2009), the FX market continued to function throughout the 2008 crisis and operationally the FX market coped well despite occasions of extremely high global volatility and transaction volumes. Therefore, we find no evidence that the FX (spot) market was a contributory factor to the systemic instability of the 2008 financial markets crisis, the catalyst for the G20 reform programme.

Nevertheless, the ACI does appreciate that the most recent incident of market misconduct involved the WMR FX fixing. With reference to our responses under Q 28-33, we would propose that the Model Code, which is a global code of conduct, should be adopted formally by the industry on both the "buy-side" and the "sell-side" and applied across the globe. As is stated by the FSB Consultative Document on Benchmarking, for codes of conduct to be effective they must be adhered to. The use of a single, globally recognised, industry-wide, unbiased code, that addresses the specific issues of the foreign exchange market will provide a tremendous amount of value to this problem.

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?

In the wake of the various industry conduct challenges, the UK Regulators have identified culture as an essential organisational focus with the key drivers for this being:

- Setting the tone from the top;
- Translating this into easily understood business practices; and
- **Supporting the right behaviours through performance management, employee development, and reinforcing through appropriate reward programmes.**

The ACI would propose that the industry support the Regulators to drive cultural change. The Model Code makes a clear statement about the responsibilities of management and supervisors to ensure that codes of conduct are adhered to. In order to facilitate firm wide cultural change leaders need to:

- Initiate a business wide directive to develop and encourage **a culture of trust and empowerment that rewards employees who apply judgment, empathy and insight to actively deliver these outcomes.**
- Operate an ethical and responsible customer-centric business with integrity and accountability at all levels
- Align business strategy and outcomes to this new model
- Put a front office control framework with protocols and procedures in place, including education programmes, personal development and evaluation measurement and the commitment to an individually accountable, **global code of conduct** so that this cultural conviction is not disregarded in either the process of business execution or future planning
- Create behaviour change programmes that ensure that leaders 'walk the walk' and demonstrate the change in tone from the top

However, the regulator themselves must be educated in the market's best practices, and be prepared to endorse good behaviour in the same way they are able to identify inappropriate behaviour. Without regulatory support for good behaviour, and an ability to both recognise it and endorse it, the industry will suffer from not being able to find "Safe Harbour" and, will operate sub-optimally.

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?

Please see our response to Q 36. There are currently a number of market wide initiatives to align market conduct, incentives and governance. As a leading non-profit, non-political association of wholesale financial market professionals, proposes that the best basis for discussion and solutions to this challenge be those articulated already in the ACI Model Code.

Importantly, the global regulators need to be prepared to play their role in endorsing good behaviour, and themselves assisting the solution by offering agreement on a suitable solution.

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?

The ACI supports the objectives of raising standards in the banking sector and rebuilding public trust.

We have a proud and illustrious history of involvement in helping educate and test individuals on ethical conduct and best practices. The ACI's Education Program provides a globally acknowledged, portable, professional qualification that enhances career prospects, improves job performance, and sets benchmarks within the industry. Our education mission is to promote the highest global standards of professionalism, competence and ethics in activities and products in financial markets through ongoing educational programmes and examinations.

The Banking Standards Review Council has identified a number of issues (particularly on culture) but is not in a position to offer practical solutions to the FICC markets on real-world issues, or guidance on conduct in these critical markets.

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?

We would advocate that it may be prudent to consider extending the the Senior Managers and Certification regime to non-bank firms active in FICC markets.

We would also advocate individual training and testing on ethical standards in accountability that reinforces the messages described above.

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?

See below Q41

Firm level surveillance

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

Firms perform trade surveillance by monitoring the trading activities of employees in order to identify potential violations such as insider or speculative trading. Most trade surveillance efforts have focused on post-trade surveillance methods .i.e. automated monitoring systems that look at trading patterns. Many institutions use and deploy such technology. In fact the FCA's system ZEN purpose built in-house system currently collates 13 million transactions reports on a daily basis, according to Patrick Spens (FCA 7/10/2014).These reported transactions, in combination with the Suspicious Transaction Reports (STRs) assist the Regulator in identifying incidences of market abuse.

Nevertheless, the most recent instances of misconduct have been conducted via chat-rooms, e-mail, SMS or telephone, whereby 'e-communication' surveillance was inadequate and adherence to firm internal policies and procedures regarding business conduct were ignored/not enforced. Electronic communication surveillance systems involving word or voice recognition features have/are being developed. Although there are claims that voice analytics software may be more effective than transcription based analytics, there is no evidence that it would necessarily have captured the most recent incidences of abuse. However, in combination with a robust behavioural culture framework and the threat of criminal proceeding, the use of such technology could act as a deterrent against future market abuse.

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)?

Most firms have processes or structures to address malpractice or deliberate misconduct, as well as to facilitate whistle blowers. However, it is clear that whistleblowing legislation has not been effective, and that the culture of whistleblowing has not extended into good governance. Further, there are indications of companies being unable to claw-back bonuses or terminate employment where the company believed these punishments would be appropriate. Legislation needs to change to reflect this, and offer a workable solution.

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?

MIFID II provisions for suspicious transaction reporting are an enhancement i. e. more robust than under MIFD I. Nevertheless, how should firms deal with suspected inappropriate market behaviour on the part of their counterparties? Suspicious transactions in relation to the Market Abuse regime are distinct from Suspicious Activity Reports (SARs) which are governed by the Proceeds of Crime Act 2002 and the Terrorism Act 2000.

Information about types of behaviour, which might constitute market abuse, such as insider dealing and market manipulation, can be found in the Code of Market Conduct (MAR1).There is also a FCA

factsheet, as well as a Market Abuse hotline. It is more appropriate that an institution reports suspected misconduct to the Regulator, where the opportunity for impartial, equitable investigation and adjudication of the situation may be effected, rather than impose self-determined sanctions on another firm. It is, of course, the prerogative of an institution to cease business with a counterparty if there are concerns regarding inappropriate market conduct.

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

The ACI would concur that the current supervisory approach and level of intensity dedicated to supervising conduct within the UK wholesale FICC markets appropriate. Institutions and individuals have had an appropriate focus on conduct brought into focus. However, it is imperative that the regulators provide endorsement and accept the expert guidance on effective markets from participants.

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?

We have seen the imposition of regulatory-level penalties for instances of proven behavioural misconduct.

While there may be potential to improve surveillance, supervision and monitoring of data, which might reveal trading anomalies and flag inappropriate trading patterns and behaviour, the ACI would propose that the introduction of any such initiatives could prove systemically onerous from a cost standpoint, most particularly for smaller market participants. Therefore, the benefits of such must be robustly proven.

We recommend the adoption of globally accepted principles for conduct via education and training, testing and supervision, as outlined above.

We also recommend that supervision on conduct be extended beyond the “sell-side providers” and examine the practices of all professional wholesale market participants.

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

Deliberate, evidenced attempts to manipulate markets through collusion or otherwise should be regarded as criminal activities and subject to criminal proceedings. This is already the case in certain European jurisdictions; where, for example, the manipulation of any financial benchmark is treated as a fraudulent, criminal activity. The risk/reward ratio must be a deterrent for such deliberate misconduct.

In instances of institution or industry wide breaches of conduct e.g. recent miss –selling of interest rate hedging products to SME customers, where a failure to evaluate client suitability or product

appropriateness appeared to be the catalyst for the misconduct, regulatory intervention in the form of a past business review to facilitate a customer remediation programme may be necessary.

Nevertheless, in instances of unintentional misconduct with no criminal intent evidenced, other measures such as re-education, probationary measures on an individual level according to the affected institution/industry conduct framework may be applied without necessarily introducing formal regulatory intervention.

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?

The ACI would not dismiss this consideration; however, we would caution against premature intervention as this might be deployed while not all facts are known, thereby potentially increasing the risk scenario.

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

Self-regulation and following best practice is the best regulation as long as it is backed up by financial regulation of participants alongside robust and appropriate legal systems that can deal with any malfeasance. We welcome the intervention of regulators and a subsequent move to a global singular regulatory response which results in establishing a global code of conduct & best practice which is internationally applicable. Alongside this we welcome the enactment of tougher punishments to violators of insider trading rules and for market manipulation. Making these a criminal offence with a minimum jail term will act as a real deterrent and will ensure the adoption of proper training in the ethics of the market based on a global conduct code such as the Model Code. A further tightening of criminal sanctions to include betrayal of trust with regard to confidential information would help in giving a code of conduct real teeth.

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 approach envisaged in the Criminal Sanctions Market Abuse Directive is appropriate for the UK and cross-border harmonisation should be encouraged so as to benefit a level playing field across financial jurisdictions. However it should be expanded were necessary to encompass all FICC markets. See our answer to Q.48 with regard to extending the activities covered. It is our view that criminal sanctions should not be instrument specific but apply to all OTC financial markets to back up market enforced discipline and best practices. For the avoidance of doubt as to who is covered by the directive it should not be applicable to only a limited number of market participants; but all market participants involved should be covered by criminal sanction be they sell or buy side.

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3. Dodd Frank Act
http://www.bis.org/press/p130905.ht

Page

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