A review of the work of the London Foreign Exchange Joint Standing Committee in 2003

This note reviews the work undertaken by the London Foreign Exchange Joint Standing Committee during 2003.

Introduction and overview

The Foreign Exchange Joint Standing Committee (henceforth referred to as 'the Committee') was established in 1973, under the auspices of the Bank of England, as a forum for banks and brokers to discuss broad market issues. The membership of the Committee includes senior staff from many of the major banks operating in the foreign exchange market in London and representatives from brokers, corporate users of the foreign exchange market and the Financial Services Authority (FSA). A list of the members of the Committee, as at end-2003, may be found at the end of this review.

The Committee met six times during 2003. At the start of the year, the main focus of the Committee's work was on the issue of undisclosed principal trading, whereas for the latter part of the year it mainly concentrated on proposals for a semi-annual survey of the UK foreign exchange market. Contingency planning has also been a focus of the Committee's agenda throughout the year. In November 2003, the Committee marked the 30-year anniversary of its first meeting by holding a seminar attended by visitors representing market committees in eight international financial centres.

Undisclosed principal trading

Undisclosed (or unnamed) principal trading is where a fund manager acts as an agent for clients who do not want their identity disclosed to a third party (usually a bank) with whom the fund manager is trading on their behalf. It is inherently risky because the third party is unable to quantify accurately the counterparty credit, legal and operational risks in undertaking the trade. In addition, there is the possibility that anti money-laundering regulations might not be properly observed.

In September 2002, the Committee decided to consult with the foreign exchange market on whether the Non-Investment Products (NIPs) Code(1) should be amended to discourage the practice.(2) Under the revised wording, a fund manager should notify the credit, compliance or legal function of the bank counterparty as to the identity of the principal for which it was acting. The front office would be unaware of the principal's identity (the bank must operate procedures to ensure this) and this would avoid any market-sensitive information being released.

Responses to the consultation were broadly positive, and the Committee agreed to hold a 'round table' meeting at the Bank in March 2003. This allowed for a direct exchange of views between banks and fund managers, and heard the views of the FSA. It was agreed that revised wording should be introduced to discourage undisclosed trading, and a working group was constituted to finalise the details.

The working group met in April. It finalised and agreed the changed wording for the NIPs Code, and also recommended that there should be a grace period of one year to allow banks and fund managers to amend their legal agreements and to make the IT system changes required to introduce the change. After consulting the other bodies that endorse the NIPs Code,(3) the Committee formally approved the change at its 15 May 2003 meeting, and the change was publicised

(1) This is a code of good market conduct for the sterling, foreign exchange and bullion wholesale deposit markets, as well as the spot and forward foreign exchange and bullion markets. It can be downloaded from: www.bankofengland.co.uk/markets/nipscode.pdf. The Committee has responsibility for its maintenance.
(2) More information on the work of the Committee in 2002 can be found at www.bankofengland/markets/forex/fxjsc/annualreview2002.pdf.
(3) The Money Market Liaison Group and the London Bullion Market Association co-ordinate the NIPs Code in their relevant markets, jointly with the Committee. The Association of Corporate Treasurers, the British Bankers' Association, the Building Societies Association, the Chartered Institute of Public Finance and Accountancy, the London Investment Banking Association, and the Wholesale Markets Brokers' Association also endorse the code.

on 28 May.(1) A working group has continued to meet, without the involvement of the Committee, to agree a pro-forma wording for legal documentation relating to undisclosed trading that banks and fund managers can exchange with each other. The Committee continues to monitor the progress of this work.

There is an international dimension to the issue because undisclosed trading also occurs in other markets, including in the United States. The New York Foreign Exchange Committee has sent a letter to US market participants, supporting the work of the Joint Standing Committee(2) and the vice-chair of the New York Committee attended the March round table meeting. The Singapore Foreign Exchange and Market Practices Committee has also endorsed the Committee's work in this field.(3) Finally, ACI—The Financial Markets Association amended its own Model Code,(4) on 18 September 2003, to discourage the practice of undisclosed trading in other financial centres.(5) The Chairman of the Joint Standing Committee has also been active in raising the issue with central banks and international bodies such as the European Central Bank and the Bank for International Settlements (BIS).

The Committee continued to monitor banks' and fund managers' preparations and expects the agreed procedures to be in place by the time the one year's grace period ends in June 2004.

Contingency planning

During 2003, the Committee and its Operations subgroup(6) continued to focus on the issue of contingency planning, and engaged in a series of tests of contingency telephone call arrangements, including some that were initiated at very short notice. The Committee and the subgroup have set up a secure web site, access to which is restricted to members of the two groups. This web site contains members' emergency contact details and would be used to exchange information during times of market disruption.

In February 2003, the Government began a consultation process on the possibility of new legislative measures to aid it in coping with a major operational disruption to the financial system.(7) The Committee asked the Operations subgroup to co-ordinate a response to these proposals for the foreign exchange market. In summary, the Committee and the Operations subgroup felt there would be significant difficulties in seeking to implement legislative proposals, given the international nature of the market. For example, by potentially allowing foreign exchange market participants operating in the UK legal jurisdiction not to settle trades, the Committee believed that legal disputes could arise with other jurisdictions, which would not be covered by the legislation.

In June 2003, after reviewing all the responses to the proposals, the Chancellor decided that a Task Force on major operational disruption in the Financial System should be formed under the leadership of Sir Andrew Large, Deputy Governor of the Bank of England. Its remit was to investigate in more depth the arguments for and against extending the legislative tools for coping with operational disruptions. Its work was aided by three working groups covering contract law, market infrastructure and regulatory powers. Members of the Operations subgroup were invited to serve on all three groups, and acted as a bridge between them, the subgroup and the Committee.

In December 2003 the Task Force concluded that legislative powers were not required at this time.(8) In addition to the international issues described above, the Task Force noted *'an overall determination on the part of all [market] participants to act pragmatically with the common purpose of getting the system up and running again as fast as possible. The initial instinct was above all to get moving again'.*(9) The Committee and the Operations subgroup

(1) See www.bankofengland.co.uk/pressreleases/2003/058.htm for a copy of this press release.
(2) See www.newyorkfed.org/fxc/2003/fxc030303b.pdf.
(3) See www.newyorkfed.org/fxc/2004/fxc040223.pdf for a copy of this endorsement.
(4) The ACI model code is a statement of good market practice endorsed by the ACI, which has regulatory standing in eight countries including Canada and Australia.
(5) See www.aciforex.com/docs/Update%2018%20DealingwithUnidentifiedPrincipals220403FinalPL.PDF.
(6) In 2002 the Committee decided that an Operations subgroup, consisting of technical settlement experts, should be created. Its remit is to cover issues relating to contingency planning; to act as a forum for the discussion of technical operational issues; to raise with the Committee the potential or actual implications of developments in these operational issues for market practice; and where appropriate to suggest actions to improve procedures or update the NIPs Code. More information on this group's other work is contained in section five of this review.
(7) The consultation document is available at www.hm-treasury.gov.uk/media//F0911/fin_disrup03.pdf, and a summary of the responses to the consultation document is available at www.hm-treasury.gov.uk/media//83FEB/fsmod_resp_sum_03_2.pdf.
(8) The report can be accessed at www.financialsectorcontinuity.gov.uk/home/pdf/tr_report_whole_report.pdf. The report recommended firms pursue a number of the recommendations set out in the Task Force Report. It is possible that the Government may consider legislation if firms do not make sufficient progress on the recommendations and if associated actions are not forthcoming.
(9) 'Report of the Task Force on Major Operational Disruption in the Financial System', page iii.

both agreed with this conclusion. A further review is expected in October 2004 which will detail progress on each of the Task Force recommendations and update on a range of business continuity issues.

The Committee continues to play an active role in the arena of contingency planning, focusing on refining its contingency phone call arrangements.

Frequent survey of the UK foreign exchange market

The Committee has been aware for some time that there is a lack of timely, robust statistics on turnover in the foreign exchange market, both in the United Kingdom and globally. The BIS co-ordinates a detailed survey of market turnover, but this only takes place every three years. The Committee plays an important role in this survey, through refining the questionnaire sent to bankers and brokers, so as to ensure that it reflects changes in market structure. Though a number of qualitative trade publication surveys are also available, no other regular quantitative analyses exist in this area.

The Committee has investigated the potential for undertaking a more regular data-collection exercise in the United Kingdom. Consultations with member banks suggested that more regular collection of a limited amount of turnover data in a format similar to that required by the BIS would not prove too onerous and would generate a number of benefits. The main

A brief history of the Foreign Exchange Joint Standing Committee

The Foreign Exchange Joint Standing Committee was established in November 1973 under the auspices of the Bank of England, to promote communication between banks and the brokers, and to facilitate the smooth functioning of the foreign exchange market. The original catalyst was provided by some difficult negotiations between representatives of the banks' Foreign Exchange Committee (FEC) and the brokers' Foreign Exchange and Currency Deposit Brokers Association (FECDBA). At that time these two bodies negotiated over the rate for brokerage on individual foreign exchange trades on behalf of the market as a whole.

The first meeting of the Committee took place on 30 November 1973 at Lloyds Bank. In addition to the Chairman and Secretary provided by the Bank of England, there were eight other members representing four banks—National Westminster Bank, Samuel Montagu, Bankers Trust and Standard Chartered—and four brokers from Charles Fulton & Co., Tullett & Riley, M W Marshall and Harlow Meyer. The Committee's first task was to agree a reduction in brokerage rates from 0.025% to 0.020% per trade for five years.

The Committee was instrumental in standardising market practice for a number of key issues, such as confidentiality and who could trade with whom. The Committee also established consistent policies on practical issues such as poaching of staff, unacceptable gifts and standardising trading language and its meaning.

One of the main themes for the Committee from its inception through to the current day has been to help to maintain a code of conduct for trading foreign exchange. As a largely wholesale, over-the-counter market, regulation of the foreign exchange market has mostly taken the form of a code of best practice. In 1973 the code of conduct took the form of an open letter to market participants from the Chair of the FEC; the existing document being the 'Stirling Letter'. The Committee worked on redrafting this and the 'O'Brien Letter' (named after the then Chair of the FEC) was issued as a replacement in 1975, and amended in 1978.

In January 1980, many of the restrictive arrangements between the banks and brokers were dismantled—allowing direct dealing between banks for example. In May 1985 the O'Brien regime was amended again and the 'Guide to Market Practice in Foreign Exchange and Currency Deposits' was issued as a result. The Financial Services Act of 1986 paved the way for further changes and in 1988 a new regime was introduced for 'The Regulation of the Wholesale Markets in Sterling, Foreign Exchange and Bullion' which incorporated a new 'London Code of Conduct'. In the following decade the FEC became part of the British Bankers' Association (BBA) and in 1992 the FECDBA disbanded. In 1994 a new body—the advantage would be the provision of robust, timely statistics on market turnover. This would give the participating banks the ability to monitor their market share, and to view trends in foreign exchange market turnover. As many banks have to undertake data-collection exercises every three years for the BIS, a more regular survey would allow economies of scale to be achieved by repeatedly using the same collection processes as for the BIS survey.

The first data were collected in April 2004, in conjunction with the BIS triennial survey, with the next survey occurring in October 2004. While the timing and content of any post-survey publication has yet to be agreed, it is likely that participating banks will have access to the data one month after the end of the survey month, followed by a public release of the aggregate data. The April collection will be treated as a pilot exercise, with the first public release after the October 2004 survey.

30-year anniversary celebrations

In November 2003 the Joint Standing Committee marked the 30-year anniversary of its first meeting. To celebrate this, the Committee decided to hold a conference and dinner/reception for former members and representatives from other international foreign exchange committees. The conference, opened by the Bank's Executive Director for Markets, Paul Tucker, had more than 70 participants. Michael Foot, a former member of the Committee and a Managing Director of

Wholesale Markets Brokers' Association (WMBA)—was formed. Both the BBA and WMBA are currently represented on the Committee.

The next major regulatory change came with the creation of the Financial Services Authority (FSA) in 1998. The FSA was given the majority of the Bank of England's supervisory functions, but it was agreed that the Bank would continue to chair the Joint Standing Committee, while the FSA would be represented on it. Over the next few years the NIPs Code (see above) was developed to replace the London Code of Conduct and formally launched in 2001.

Apart from maintaining the codes of conduct, the Committee spent much of its time before 1998 arbitrating on trade disputes between the banks and brokers. The Committee continues to advise on the interpretation of the NIPs Code, but the need for this arbitration function has largely ceased to exist.

The other main theme of Committee discussions over 30 years has been the impact of new technology. The 1970s saw the first introduction of the recording of dealers' conversations and 'squawk boxes' (which relayed conversations out loud) and, early in 1977, the first mention of the Reuters dealing system to replace phone lines and facilitate direct dealing. The 1980s were dominated by a range of technological issues—including concerns over the telecommunications infrastructure in London—and automated confirmation systems that were introduced from 1984. In April 1989, the first global turnover survey was conducted—resulting from an initiative in London as early as 1985.

In the 1990s there were further structural developments: the Committee discussed the relocation of back offices overseas as early as 1994, and contingency planning following the Bishopsgate bomb in 1993. The Allsopp report on settlement risk in 1996 led eventually to the introduction of Continuous Linked Settlement in 2002, and this has been a regular discussion topic. In the second half of the 1990s the Committee also discussed the introduction of the first internet-based trading systems, the single European currency and the potential impact of the 'Millennium Bug'.

Since 2000, the Committee has expanded its membership to a total of 25. There are generally six meetings a year, with the facility to call extraordinary meetings and conference calls as required. Since 1998, the Committee has been working on expanding its contact with foreign committees through the exchange of minutes and information on market practices and through working together on issues of common interest such as contingency planning and codes of conduct. The Committee's web site was launched in July 2001 to highlight its work.(1)

(1) This can be found at www.bankofengland.co.uk/markets/fxjsc.

the FSA, made a presentation on the history of the foreign exchange market and some of the current issues. In addition, there were presentations from the Chairs of the New York and Tokyo foreign exchange committees, and from a member of the ECB Foreign Exchange Contact Group. Discussions were wide-ranging, covering regulatory and ethical standards in the foreign exchange market, Asian exchange rate regimes, and the impact of e-commerce.

The dinner was held at the Vintners Hall in London, with a reception hosted by Rachel Lomax, Deputy Governor of the Bank. The Committee was pleased to welcome three of the participants from its first meeting—Allan Orsich, Derek Tullett and Terry Smeeton—with the latter two speaking about the early days of the Committee. Some 120 people attended including representatives from over 20 central banks.

The work of the Operations subgroup

The subgroup has worked extensively on contingency planning issues (see above). It has also addressed developments in and the impact of Continuous Linked Settlement[(1)] (CLS) on the foreign exchange market. CLS is a payment-versus-payment settlement system for foreign exchange transactions that has eliminated the principal risk for those trades that it settles. CLS volumes and values have grown strongly since the system was launched in September 2002 and the daily value of transactions settled now frequently exceeds $1 trillion—a significant proportion of the interbank market. The subgroup has also monitored how market practice has evolved following its introduction, and notably how institutions have responded to rare incidents of disruption to CLS.

The subgroup has also set up working groups to review existing NIPs Code guidance relating to Standard Settlement Instructions, as well as documentation issues relating to Prime Brokerage; to encourage the use of Confirmations in post-trade processes; and most recently to encourage service level agreements with customers. These working groups are chaired by members of the subgroup, and are seen as a useful mechanism for allowing experts at member banks to participate in, and augment, the work of the subgroup.

The subgroup has also reviewed the special recommendations of the Financial Action Task Force on Money Laundering (FATF),[(2)] monitored discussions regarding the possible introduction of a central clearing counterparty for the London foreign exchange market, and reviewed developments in the outsourcing of settlement functions abroad.

Other subgroups

The E-commerce subgroup was re-formed in 2003, and presented findings at the May 2003 meeting. Its report was included in the Summer 2003 edition of the *Quarterly Bulletin*[(3)] and also published in *E-Forex Magazine*.[(4)] The Committee has paid particular attention to developments in this area, it has received presentations on prime brokerage and CLS, and has increased its membership to encompass a representative from an e-commerce portal. In 2004, the Committee plans to form new subgroups to cover the work of banks' chief foreign exchange dealers, and to discuss legal and related issues in the foreign exchange market.

International co-operation

One of the motivations behind holding the 30-year anniversary conference was to further the Committee's objective of fostering and improving links with the other international foreign exchange committees. To this end, the Chair and Secretary of the Committee have attended meetings of the ECB and the New York foreign exchange committees, and the Secretary of the ECB committee and the Chair of the New York committee attended Committee meetings in 2003. The Chair of the Operations subgroup was a member of the counterpart ECB committee, and one member of the subgroup is a member of the New York Operations Managers Working Group.

In September, the New York Foreign Exchange Committee held a global operations conference in New York. Members from seven international operations committees, including the Operations subgroup, attended. A common theme that has arisen from meetings with international contacts is the need for greater co-ordination between the various codes of market practice used. To that end, the Operations subgroup has begun to review the NIPs Code and to

(1) CLS is a payment-versus-payment settlement system for foreign exchange transactions. For more details see the *Bank of England Quarterly Bulletin*, Autumn 2002, pages 257–58. For more information on CLS see www.cls-group.com.
(2) Particularly Special Recommendation VII, which covers customer information to be included in cross-border payment messages. See www.fatf-gafi.org/40Recs_en.htm#Reporting for further details of the FATF Special Recommendations.
(3) See www.bankofengland.co.uk/qb/qb030208.pdf.
(4) See www.bankofengland.co.uk/markets/forex/fxjsc/fxjscecomm2003.pdf.

compare it with both the ACI Model Code and the code of good practice endorsed by the New York Committee (the '60 best practices').[1] And the Operations subgroup is discussing areas of common interest with its New York counterpart, for both committees to collaborate on.

The Committee will continue to foster international links in 2004. The main Committee will continue to undertake reciprocal visits to other committees, and the Operations subgroup is likely to host a global operations conference in London in 2004 or 2005.

(1) Its full title is 'The management of Operational Risk in foreign exchange'. See www.newyorkfed.org/fxc/2003/fxc033103.pdf for a copy of this document.

Members of the London Foreign Exchange Joint Standing Committee as at December 2003

Name	Firm/Organisation
Mike Beales	Wholesale Markets Brokers' Association
Marcus Browning	Merrill Lynch
Adam Burke	JPMorgan Chase
Alan Collins	Bank of America
Darren Coote	UBS
Jeff Feig	Citibank
David Gibbins	Royal Bank of Canada
Brian Gracey	HSBC and Chair, FXJSC Operations subgroup
Geoff Grant	Goldman Sachs
David Hacon	Financial Services Authority
John Herbert	Garban Intercapital
Simon Hills	British Bankers' Association
Jack Jeffery	EBS
Michael Kahn	State Street
Shigeyasu Kobayashi	Bank of Tokyo-Mitsubishi
Rob Loewy	HSBC
Peter Murray	Morgan Stanley
Peter Nielsen	Royal Bank of Scotland
Ivan Ritossa	Barclays Capital
Jon Simmonds	Crédit Agricole Indosuez
Matt Spicer	CSFB
Gordon Wallace	Deutsche Bank
Phil Weisberg	FXAll
Brian Welch	The Association of Corporate Treasurers
Paul Fisher (Chairman)	Bank of England
Sumita Ghosh (Secretary)*	Bank of England

*Andrew Grice was Secretary of the Committee and its Operations subgroup until the September 2003 meetings.

Members of the FX JSC Operations subgroup as at December 2003

Name	Firm/Organisation
Andrew Brown	CSFB
Jos Dijsselhof	ABN Amro
Michael Douglas	Bank of America
John Godfrey	Goldman Sachs
John Hagon	CLS
Barry Holland	Barclays Capital
Elaine Kelly	Deutsche Bank
Brian Leddy	Mellon Bank
Chris Mann	Bank of England
Leigh Meyer	Citibank
John Moorhouse	Reuters
Mike Neale	JPMorgan Chase
Oonagh O'Neil	Morgan Stanley
Derrick Pearson	Lloyds TSB
Colin Perry	ICAP
Steve Portway	UBS
Stephen Smith	State Street
Allan Spallding	SWIFT
John Whelan	Association of Foreign Banks
Richard White	Royal Bank of Scotland
Brian Gracey (Chairman)	HSBC
Simon Hills (Vice-chairman)	British Bankers' Association
Sumita Ghosh* (Secretary)	Bank of England

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