



BANK OF ENGLAND

# Speech

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## **In codes we trust – Redefining the social licence for financial markets**

Speech given by

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Briefing on the financial markets codes of practice to the Association of  
Corporate Treasurers, Bank of England

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## *Introductory Remarks*

Financial markets play an important role in our economy. They help determine the borrowing costs for households, companies and governments, facilitate cross-border trade and investment and enable corporates and other participants to manage and transfer financial risks. As corporate treasurers, I'm sure the effective functioning of the markets you operate in is important to you.

Financial markets are important to central banks too. Their effective functioning can help support broader economic growth, and promote financial stability. And they also play an important role in enabling the Bank of England to conduct operations and implement policies that help promote monetary and financial stability. It is therefore in the Bank's interest to support the development of effective market infrastructures and encourage good behaviours.

The Governor noted in his Mansion House speech in 2015<sup>1</sup> that markets are a powerful means for prosperity and security for all, and as such they need to retain the consent of society – what he termed a 'social licence' – to be allowed to operate, innovate and grow. Unfortunately, the scale of misconduct that has emerged since the financial crisis has both damaged public trust and impaired the effectiveness of important markets. We need to rebuild that trust, and markets need to regain their social licence.

In order to do that we need to ensure that there are appropriate infrastructures in place supporting financial markets. By infrastructures I don't just mean physical infrastructures such as trading venues and settlement systems. I also mean 'social' infrastructures such as standards of market practice and codes of conduct. And once embedded, these infrastructures need to be constantly monitored, and evolve to keep pace with underlying markets and social expectations.

That's not something the authorities can do on their own. It is going to require all market actors, both public and private, to recognise their responsibilities to the system as a whole and work together to redefine the 'rules of the game'. There should be benefits for all involved, both in terms of understanding what is expected of you as a market participant, but also what you should expect of others in the market, which can be a powerful tool in itself. So everyone should have an incentive to play their part.

Today I'm going to take you through a couple of examples of initiatives that the Bank is involved in which are looking to promote more effective markets, and how these are likely to be relevant to you. But before I get to those examples I want to take a couple of minutes to provide a bit of background on the broader work that the Bank and other UK authorities have done in this area.

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<sup>1</sup> <http://www.bankofengland.co.uk/publications/Pages/speeches/2015/821.aspx>

## *The Fair and Effective Markets Review – 3 years on*

This June marks three years on from the launch of the Fair and Effective Markets Review (FEMR). This was a comprehensive, point-in-time stock take of market functioning and effectiveness across Fixed Income, Currency, and Commodity (FICC) markets. It involved a wide-ranging consultation phase where the Bank heard from a wide range of market participants including corporate treasurers, asset managers, infrastructure providers and banks – with over 800 meetings and nearly 1000 pages of written submissions.

FEMR made a number of recommendations aimed at raising standards and restoring trust in FICC markets. The authorities have subsequently worked with market participants to make important strides in taking forward these recommendations and achieving the overall goals of this initiative.

The FEMR implementation report<sup>2</sup> noted that, in some cases, the main impediment to necessary changes in market infrastructure may be the absence of a ready means for users to co-ordinate on a preferred way forward. So FEMR recommended the creation of the new FICC Markets Standards Board (FMSB), with participation from a broad cross-section of firms and end-users involving regular dialogue with the authorities. This Board has been up and running since 2015 and is aiming to improve conduct, professionalism and accountability of individuals through producing standards and guidelines, practical case studies and other materials on market practice. The FMSB has been involved in the production of the Codes we are here to discuss today.

More broadly, FEMR also recommended that public authorities should stand ready to help catalyse market-led reform held back by private sector co-ordination failures. In some cases that might involve a direct public role in infrastructure development. In others, the Bank is able to use its convening powers to bring market participants together to achieve market-led reforms.

### *Interest rate benchmark reforms*

The first example I want to discuss has used both of these tools. Following cases of attempted manipulation of global reference rates, the Financial Stability Board (FSB) in 2014 recommended the development of near risk-free interest rate benchmarks that could be used as alternatives to Libor, alongside the reform of the existing benchmarks such as Libor. The aim was to ensure the availability of a set of robust benchmarks that would allow market participants to appropriately manage their risk.

In the UK, the key sterling unsecured benchmark was the Sterling Overnight Interest Average (SONIA). But the underlying market on which SONIA was based was declining in size and, in order to ensure its future robustness, it needed to be reformed. Given the importance of SONIA to the wider market – the notional

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<sup>2</sup> <http://www.bankofengland.co.uk/markets/Documents/femr/implementationreport.pdf>

value of outstanding derivative contracts that referenced SONIA exceeded £7 trillion in October 2016 – and the challenges in collecting the necessary data to reform the benchmark, the Bank took the decision to take over the administration of SONIA. We are now in the process of reforming it to be based on a new collection of money market transactions data, covering a much wider range of transactions than the existing SONIA benchmark.

The Bank also convened a private sector working group to decide on the appropriate sterling near risk-free rate. That group considered a range of potential rates, including both secured and unsecured benchmarks. It recently recommended the Sterling Overnight Interest Average (SONIA) as the preferred alternative to sterling Libor. This expression of market support for SONIA as the sterling near risk-free rate is a major milestone in the benchmark reform process.

The group's work now moves on to its next phase which considers how best to promote the use of SONIA in sterling markets, through active outreach to market participants. As regular users of Libor, corporate treasuries will be affected by these plans and have a potentially key role to play in supporting the adoption of a reformed SONIA benchmark, which is expected to take place over the coming years. For that reason I encourage the ACT and its corporate members to engage with the Bank and the Working Group over the coming months.

#### *Codes of Conduct*

A further example of how the Bank has been working with market participants in the UK and globally to catalyse much needed market-led reforms is the development of new codes of conduct covering the Global FX and UK Money Markets.

Codes of good or best practice are ultimately another mechanism to embed good behaviours amongst market participants in the absence of, or in complement to, market regulation. They can be thought of as one form of licence to manoeuvre through constantly evolving financial markets, including defining the red, amber and green signals that market participants must be aware of when operating in them.

Codes of practice for these markets are nothing new. Market conduct in a number of typically lightly regulated over-the-counter markets was previously covered by guidance set out in voluntary market codes of good practice. The Bank of England has historically played a role in co-ordinating the production of several of these. The most prominent was the Non-Investment Products (NIPs) Code, which applied to sterling and foreign currency wholesale deposits, spot and forward FX, and bullion. There was also a Securities Borrowing and Lending Code and a Gilt Repo Code, which were owned by the Bank-chaired Securities Lending and Repo Committee. All these codes had become out-dated and obsolete – FEMR noted that all of the FICC market enforcement actions brought against firms in the UK contravened the provisions of the NIPs code in relevant markets. So the case for reform was clear.

Three new codes of conduct have now replaced these former codes: the UK Money Markets Code and the FX Global Code, which are the focus today's session, as well as the Global Precious Metals Code<sup>3</sup>. These codes were launched in April and May this year. They establish reformed guidance on conduct and market practice for participants active in these markets, and provide mechanisms to encourage and increase adherence to these standards.

The markets these codes cover are big and important. Trading in foreign exchange markets averaged \$5.1 trillion per day globally in April 2016. In the sterling deposit and repo overnight markets last year, the average daily number of transactions was 3,000, with a total value of over £160bn. This underlines the need for participants to understand and adhere to high standards of market conduct. And every participant who uses these markets, regardless of the scale and extent of their operations, has an individual responsibility to play a part.

The development of the Codes has very much been a partnership between public and private sectors. The Codes apply to all market users – covering buy-side, sell-side, bank and non-bank participants, as well as trading platforms and other market infrastructure – and the engagement has necessarily been as diverse. We've been very grateful for the engagement of the ACT, representing your views as important participants in these markets, as the Codes have been developed. I hope the process by which both Codes were developed will provide market participants with confidence that the Codes accurately reflect good, and achievable, market practice.

All the codes are aligned along the same fundamental principles. These are intended to promote robust, fair, liquid, open and appropriately transparent markets supported by effective infrastructures. The principles specifically cover: Ethics, Governance, Compliance and Risk Management, Information Sharing, Execution and Settlement practices in the respective markets.

So we have good quality codes, but clearly that alone is insufficient: The Codes will only rebuild trust if they are actively used and widely adopted by market participants and drive a market-wide shift in culture and attitudes – one that embeds behavioural norms that are consistent with both the letter and spirit of the Codes. That is where you come in. These codes are voluntary, but we very much hope you will all feel able to sign up to the principles contained in the codes.

There are good reasons why you, as corporate treasurers, should want to sign up to the code. The first is that obligations in these markets don't just fall on the sell-side. There are responsibilities that directly apply to the buy-side too. The Codes set out what those responsibilities are and what the expectations are for you to manage them. To take a couple of examples, the Global FX Code talks about handling transactions that could have a sizable impact on the market, such as those associated with merger and acquisition activity.

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<sup>3</sup> <http://www.lbma.org.uk/assets/downloads/pmc.pdf>

It also sets out expectations around confirming block trades, with a worked example of non-compliant behaviour by a corporate. Understanding your responsibilities in these markets will help you manage your business in a way that is consistent with established good practice.

The second reason for signing up is that the Codes define how corporates should expect to be treated by their banks and other market participants. Again, to take an example, banks have an obligation to set mark-ups for clients in a fair and reasonable manner, and the Code promotes transparency around this process. So the Code should help ensure you are treated fairly, if your bank has signed up. But importantly, it should also help you to be an informed market participant by providing a framework for you to engage with your bank, and setting out the information you should expect to receive. So you should view the Codes as tools that support your access to these key markets on a fair and consistent basis.

What does “signing up” to the codes mean in practice? There are two points I’d like to make here. The first is on the concept of adherence, and specifically what steps market participants should take. The FX Global Code has an accompanying report on adherence<sup>4</sup>, but in my view it applies equally to both Codes. As set out in that report, there are three key steps towards adherence that market participants are encouraged to take: (i) embed the Codes’ principles in your day-to-day practices, (ii) monitor, through time, how effectively you have done so, and (iii) demonstrate your own adherence to the Codes, to counterparties and others. To facilitate public demonstration of adherence, a tailored Statement of Commitment has been developed for each Code. This should provide market participants with an accessible and standardised means of demonstrating Code adherence, without the need to provide bespoke sign offs for different counterparties and service providers. Widespread use of the Statement of Commitment can also help to raise awareness about, and increase the profile of the Codes. I encourage all market participants, including all of you in this room, to use the Statement of Commitment, as we at the Bank will be doing.

The second point I want to make is on the concept of proportionality. When writing the codes we were very conscious that they were going to apply to a diverse group of market participants, and there was unlikely to be a “one size fits all” solution. The appropriate steps for a large sell-side participant to take to align its activities with a given principle will necessarily differ from the appropriate steps to be taken by a small corporate. So the concept of proportionality has been strongly embedded in both Codes. This should make it possible for all market users to align their activities to the Codes in a way that is appropriate for their business.

### *Concluding Remarks*

It has been very encouraging to see the work and engagement between public authorities and market participants to promote fair and effective markets over the last few years. The work on benchmark reform

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<sup>4</sup> <http://www.bankofengland.co.uk/publications/Documents/speeches/2016/speech924.pdf>

and the development of Codes of Practice are just two concrete examples of the work that has been done to rebuild the social licence that markets need to operate effectively. But this is by no means the end of the story. The evolution of markets requires continuous and forward looking engagement, so that market infrastructures are kept up to speed with market innovations. That will remain an ongoing challenge, and one that will require all market participants to work together and do their bit for the good of the overall financial system.