FX Global Code of Conduct: One year on – has behaviour improved?

Oct 10 2018 Stephen Elam

It is now well over a year since the launch of the FX Global Code of Conduct in May 2017.

This was a high-profile response to the series of scandals and huge fines imposed by regulators and authorities globally in 2013-15 for FX rate manipulation and related misconduct. In the UK, the conduct was so severe that it resulted in £1.4 billion in Financial Conduct Authority fines and brought about the launch of the FCA FX Remediation Programme.

The aim of the code was, and is, to restore trust and credibility to FX markets. It seeks to drive best practice and improved behaviours through a series of 55 principles — but importantly not rules — that are designed to promote the integrity and effective functioning of wholesale FX markets.

Is it working, and can a global code really be expected to improve behaviours? There may be some initial grounds for scepticism.

- Adherence with the code is voluntary: participants sign up to a public statement of commitment, but they do not have to.

- It does not impose any legal or regulatory obligations on market participants, nor does it replace any existing law or regulation. The code represents global good practice (the FCA considers adherence to the principles would represent best practice), but when it comes to looking at the conduct of a market participant, the principles would ultimately fall to be considered in conjunction with local laws and regulations.

- Codes of "best practice" are not new – take a look at the annexes to the FCA final notices for the huge FX fines. They set out provisions from the code of conduct in place at the time: the NIPs (Non-Investment Products) Code. Tellingly, however, its provisions form no part of the analysis of the misconduct in the notices. The FCA described this code as a statement of "good practice guidelines", but if it did not help guide behaviours then, why should it now?

What makes the FX Global Code different?

Are there grounds for thinking that things will be different this time? There are, in fact, quite a few reasons to believe that the answer is yes.

Level of take-up has been significant. According to the Global Foreign Exchange Committee (GFXC), which promotes, monitors and updates the code (a positive in itself), more than 470 market participants that have signed statements of commitment. The GFXC reported more than 100 signatories in April 2018, so there appears to be genuine momentum in greater take-up over recent months. Linked to this, the GFXC has recently launched a Global Index of Public Registers, linking registers from a global spread of jurisdictions into a combined list of participants.

On any view, these numbers are impressive, particularly where signing a statement of commitment confirms support for the code, commitment to market conduct in line with its principles, and critically, that steps have been taken to align a firm's activities with the code's principles. This is not an overnight commitment, and compliance takes time and resource.

A further reason is the time and effort that has gone into the creation and development of the code. Although launched in 2017, it was two years in the making through a public-private partnership between central banks and major FX market participants, at the behest of the Bank for International Settlements. Through extensive and prolonged industry dialogue, conduct of banks may have started to align with the principles in the code, even prior to implementation. Significant effort has been made to

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ensure the principles have practical effect: an important feature of the code is that the principles are supplemented by a long annex of illustrative examples to demonstrate how the principles would be applied to real-life trading situations, including many of the familiar scenarios that have given rise to historic misconduct.

But even with the best will, and with global cooperation, how does a voluntary code with no binding legal effect have real effect in changing cultures and behaviours? The answer, from a European perspective at least, may be found in wider regulatory developments. Banks have been subject to a difficult and painful period of regulatory change. There has been huge focus on the Market Abuse Regulation (MAR) and the Markets in Financial Instruments Directive II (MiFID II) which address issues that are analogous to many of those behind the principles in the code: for example, market abuse, surveillance of communications, insider dealing. The overhaul of compliance, procedures and systems to meet this regulatory change have probably created a better foundation than ever before for banks to incorporate and comply with the code.

The future of the FX Global Code: all market participants

While take-up was been positive, the numbers hide an important issue, and an important theme for the future of the code. Of the 470 or so signatories, the large majority, approximately 75 percent, are banks. It is tempting to think that this is rightly so; after all, it was the misconduct of large banks that has driven the need for the code. And it should be the banks leading the drive to restore credibility back into FX markets. It makes sense from a competition perspective too: if you were a fund or corporate transacting large FX volumes, you would logically want a bank counterparty that had signed up to these principles.

This, however, misses the point that the code is intended to apply to all wholesale market participants, including buy-side firms. This is a much greater challenge. Take-up here is much lower, and perhaps understandably so. There is less incentive for buy-side firms to sign up to a voluntary code where there is no commercial advantage in doing so. Even though the code adopts proportionality, meaning that firms only apply measures required given their operation and role in FX markets, why would a fund assume responsibility for integrating the code into business practice and systems voluntarily (particularly where recent regulatory change has imposed a huge time and cost burden upon funds already)?

The GFXC is alive to this challenge, and would say that the code helps buy-side firms' understanding of practices that their counterparty banks follow and informs what to expect from those relationships. It might also provide an opportunity to benchmark against global best practices and contribute to continued consultation and improvements to the code. These are all valid points, but perhaps not reasons for adherence in themselves.

If buy-side interests and concerns are addressed in the continuing work of the GFXC, this can only help. A particular concern has been last look, the practice whereby a counterparty can refuse to accept a trade request at the last minute, and ensuring sufficient transparency around its operation. The GFXC has consulted on this issue, and updated the terms of the code. Most recently, the latest version of the code includes an additional illustrative example concerning pre-hedging, another issue that been subject to historic misconduct, and a concern for buy-side participants.

A longer-term challenge

There is much to be applauded in the development of the FX Global Code to date, and the work being done by the GFXC to encourage global adherence. If the code is genuinely going to restore trust and credibility to FX markets, however, it will need to continue to evolve, and to involve all market participants. The good news is that the GFXC appears to appreciate this, even if making it happen will be a longer-term challenge.

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