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FX Global Code

-- Formulation of a Single Global Code of Conduct for the Foreign Exchange Market and Initiatives to Promote Widespread Adherence --

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Misconduct in overseas foreign exchange (FX) markets that came to light in 2013 led to increased recognition of the importance of enhancing discipline in the global FX market. Beginning in 2015, the Foreign Exchange Working Group (FXWG), under auspice of the Bank for International Settlements (BIS) Markets Committee, undertook the formulation of a single global code of conduct for the FX market. After a two-year initiative, the final FX Global Code (Global Code) was published on May 25, 2017. The Global Code, expected to apply to all wholesale FX market participants, strengthens discipline in various areas of market participants' FX activities, and provides a variety of mechanisms to promote voluntary adherence by market participants. For the FX market to function smoothly, the Bank of Japan expects adherence to the Global Code by a wide range of market participants, and will continue to work closely with other central banks and private market participants to support initiatives to ensure the soundness of the FX market.

Introduction

A diverse set of market participants, including financial institutions, corporates and retail investors, transact in the FX market as a result of market liberalization. Moreover, over-the-counter (OTC) transactions prevail in the FX market, and trading venues have diversified as more transactions are conducted through electronic platforms[1]. In light of such diversity, Codes of Conduct, to which market participants voluntarily adhere, have traditionally played a vital role in the FX market rather than laws and regulations.

However, after FX-related misconduct in overseas markets such as London came to light in 2013[2], widespread recognition of the need to strengthen market discipline led to initiatives undertaken by international institutions including the Financial Stability Board (FSB) and regional Foreign Exchange Committees (FXCs) which comprise private market participants and central banks.

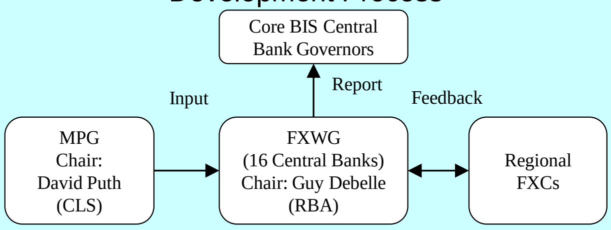
The FSB, in its final report entitled "Foreign Exchange Benchmarks" published in September 2014, set forth recommendations concerning calculation methodology for FX Benchmarks and transactions using them[3]. Further, FXCs of eight major financial centers (Australia, Canada, the Euro Area, Hong Kong, London, New York, Singapore, and Tokyo) adopted the "Global Preamble" in March 2015, which provides a set of common high-level principles to be referenced by Codes of Conduct in each market, although it did not go so far as to unify the regional Codes[4].

Although each of these initiatives tackled the task of strengthening FX market discipline from different angles, no initiative covered the entirety of FX transaction processes, nor did they resolve the predicament of different regional Codes of Conduct being applied in each market. Meanwhile, some pointed out that regional Codes of Conduct did not sufficiently infiltrate through the personnel in charge of market participants' daily FX activities.

Under such circumstances, central banks increasingly called for a further step to be taken and in May 2015, central bank governors of the core members of the Bank for International Settlements (BIS) established the Foreign Exchange Working Group (FXWG), under auspice of the BIS Markets Committee, to facilitate the development of a single global code of conduct for the foreign exchange market (Global Code) and to promote greater adherence.

The FXWG consists of central banks representing 16 jurisdictions around the globe[5]. Central banks and private market participants have closely collaborated in the process of developing the Global Code: the Market Participants Group (MPG) consisting of more than 40 private-sector professionals from around the world has provided insights to the FXWG[6]; and regional FXCs that play important roles in developing and maintaining regional Codes of Conduct have actively provided feedback (Chart 1).

[Chart 1] Structure of the Global Code's Development Process



Work by the FXWG was carried out in two phases. In the first phase, an interim Global Code covering just over half of the Code's contents, including the "Ethics" and "Information Sharing" sections, was formulated and published in May 2016 along with a report on adherence to the Global Code. The second phase brought forward work to formulate the remainder of the Global Code (including the "Governance" and "Risk Management and Compliance" sections) and expanding "Illustrative Examples." The final Global Code and the final report on adherence to the Global Code were published on May 25, 2017[7].

Features of the Global Code

The Global Code is intended to promote a robust, fair, liquid, open, and appropriately transparent FX market. It is based on the existing Codes of Conduct in major markets, while discipline is strengthened in various facets of FX activity to prevent misconduct. Also, to address concerns that the regional Codes have not been sufficiently understood and adhered to in market participants' daily FX activities, work has been put into the Global Code to make it easy to read, understand and use in daily activities.

Applies to all Wholesale FX Market Participants

The Global Code applies to all market participants of the wholesale FX market, including not only sell-side (financial institutions) but buy-side (customers) participants. Examples of wholesale market participants include financial institutions, asset managers, corporate treasury departments, brokers (including retail FX brokers), E-trading platforms, and firms running automated high-frequency strategies (HFTs)[8]. On the other hand, retail investors (the general retail public) are outside the scope of the Global Code.

This is based on the idea that as the boundary between sell-side and buy-side participants has become ever more blurred amid structural changes in the market, it is natural to ask for adherence to the Global Code from all market participants including the buy-side. However, it must be noted that the details and level of adherence expected from each market participant would vary depending on the nature of the market participants' engagement in the FX market, as outlined later (see "Adherence to the Global Code").

A "Single" Global Code

The Global Code of Conduct will replace existent regional Codes of Conduct, and is expected to become the single code applicable to markets around the globe. The Global Code should put an end to the predicament of different regional Codes of Conduct being applied in each market, and henceforth is expected to enhance market participants' usability.

Flexibility with Regards to Diversity Across Markets

Meanwhile, markets across the globe may have specific practices in place due to various historic backgrounds. To address such diversity, FXCs in each market may issue local standards to the extent that the standards do not interfere with the spirit (aim) of the Global Code. The Global Code is structured with such flexibility in mind.

Covers Various Facets of FX Activities

The Global Code is composed of six sections: 1) Ethics, 2) Governance, 3) Execution, 4) Information Sharing, 5) Risk Management and Compliance, and 6) Confirmation and Settlement. Each section is organized around leading principles (Chart 2), under which a total of 55 principles are assembled.

These six sections are intended to encompass various aspects for the market participant to conduct their FX activities in a sound manner (Chart 3).

Efforts to Enhance Usability

To render the Global Code easy to read, understand, and use in daily activities, a strong emphasis was placed on using plain and unambiguous language. Also, the Code aims to reflect the strength of the underlying standard by distinguishing between expressions such as "should" and "be encouraged to."

[Chart 2] Six Leading Principles

1) Ethics

- ✓ Market Participants are expected to behave in an ethical and professional manner to promote the fairness and integrity of the FX Market.

2) Governance

- ✓ Market Participants are expected to have a sound and effective governance framework to promote responsible engagement in the FX Market.

3) Execution

- ✓ Market Participants are expected to exercise care when negotiating and executing transactions.

4) Information Sharing

- ✓ Market Participants are expected to be clear and accurate in their communications and to protect Confidential Information.

5) Risk Management and Compliance

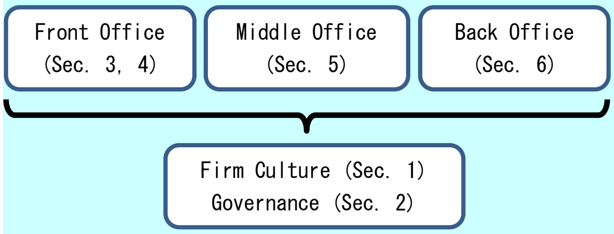
- ✓ Market Participants are expected to promote and maintain a robust control and compliance environment to effectively identify, manage, and report on the risks associated with their engagement in the FX Market.

6) Confirmation and Settlement

- ✓ Market Participants are expected to put in place robust, efficient, transparent, and risk-mitigating post-trade processes to promote the predictable, smooth, and timely settlement of transactions in the FX Market.

Note: Excerpt from the Global Code.

[Chart 3] Various Facets of FX Activity addressed by the Global Code



In order for market participants to understand the principles and incorporate them into their day-to-day operations, it is beneficial to provide illustrative examples of acceptable and unacceptable practices within the Global Code. It has been pointed out that some financial institutions conduct their FX activity based on overly conservative internal policies as a reaction to paying massive fines for prior misconduct. In this sense, preventing over-cautious behavior by clearly addressing what market participants can do under the Global Code may lead to improvement in market functions. Based on this idea, the Global Code sets out illustrative examples of acceptable and unacceptable practices with explanations, especially regarding principles in 3) Execution and 4) Information Sharing sections (Chart 4).

[Chart 4] Illustrative Examples

<u>Communication regarding "Market Colour"</u>

[NG] We've seen large NZD/USD demand from XYZ (where "XYZ" is a code name for a specific Client) this morning.

→ It is inappropriate to communicate information specifies a certain client.

[OK] We've seen large NZD/USD demand from Real Money names this morning.

→ The term "Real Money names" appropriately anonymises the client.

<u>Communication regarding "Confidential Information"</u>

[NG] Our view on USD/JPY has shifted in line with our new central bank rate forecasts and I'm publishing a new bullish trade recommendation later today.

→ It is inappropriate to communicate information contained in unpublished research.

[OK] I'm calling to check that you've received our bullish USD/JPY trade recommendation published an hour ago in line with our new central bank rate forecasts.

→ It is appropriate to communicate information contained in research only after it is published.

Note: Excerpt from the Global Code.

These illustrative examples were originally adopted in the "Code of Conduct -- Guidelines of Foreign Exchange Transaction (Tokyo Blue Book)," published by the Tokyo Foreign Exchange Market Committee (Tokyo FXC) (see "Initiatives by the Tokyo FXC") in April 2015. The Tokyo Blue Book clarified practical details of Tokyo's Code of Conduct by using examples of acceptable and unacceptable practices and was highly recognized by the international community.

Promoting Adherence to the Global Code

Voluntary Adherence to the Principle-based Code in Line with the Principle of Proportionality

Similar to the existing regional Codes of Conduct, the Global Code is neither law nor regulation, and hence is valuable only when it is voluntarily adhered to by a wide range of market participants. In this regard, adherence to the Global Code is intended to be based on the "Principle of Proportionality": the steps that different market participants take to align their activities with the principles of the Global Code will necessarily reflect the size and complexity of the market participant's FX market activities, and the nature of the market participant's engagement in the FX Market. Furthermore, it is stated that the decision of what steps should be undertaken, and in what manner, resides with each market participant, reflecting an appropriate internal assessment.

Fostering voluntary adherence by market

participants was valued in the development of the Code itself; the Global Code is principle-based rather than prescriptive or rule-based, leaving some room for interpretation, to require market participants to exercise judgment according to the nature of their FX activities. In other words, since the Global Code is principle-based, market participants are expected to consider the objectives of the Global Code on their own and not to adhere only to what is mentioned.

Statement of Commitment

The FXWG recognizes the importance of market participants publicly demonstrating their commitment to adhere to the Global Code. It is envisaged that market participants' widespread demonstration of their commitment to adhere to the Global Code will increase awareness of the Code, thereby encouraging adherence by a larger breadth of market participants. From this perspective, the "Statement of Commitment" was designed to provide a common basis by which market participants could publicly demonstrate their commitment to adhere to the Global Code (Chart 5).

[Chart 5] Statement of Commitment

> [Name of Institution] has reviewed the content of the FX Global Code ["Code"] and acknowledges that the Code represents a set of principles generally recognised as good practice in the wholesale foreign exchange market ["FX Market"].
>
> The Institution confirms that it acts as a Market Participant as defined by the Code, and is committed to conducting its FX Market activities ["Activities"] in a manner consistent with the principles of the Code.
>
> To this end, the Institution has taken appropriate steps, based on the size and complexity of its Activities, and the nature of its engagement in the FX Market, to align its Activities with the principles of the Code.
>
> [Name of Institution]
>
> Date : ____________________

Note: The Global Code.

The "Statement of Commitment" is intended to be used by a market participant to announce that it (i) supports the Global Code and recognizes it as a set of principles of good practice for the FX Market; (ii) is committed to conducting its FX Market activities in a manner that is consistent with the principles of the Code; and (iii) considers that it has taken appropriate steps, based on the principle of proportionality, to align its activities with the principles of the Code.

Market participants may publicly demonstrate their commitment to conduct their FX activity in line with the Global Code, for example, by publishing it on their website.

Public Registers of Statements of Commitment

To enhance incentives for market participants to publicly demonstrate their commitment, it would be beneficial to create a mechanism by which the general public could easily obtain information on which market participant has committed to adherence to the Global Code.

To address this, Public Registers -- websites where Statements of Commitment submitted by market participants are posted -- is under consideration. Due to the diversity of market structures across jurisdictions, various bodies are envisaged to become hosts of Public Registers, such as FXCs, industry associations, private trading platforms, and central banks (the Tokyo FXC plans to become the Public Register in Japan, as described later).

In addition, discussion is underway to take this initiative a step further and establish a mechanism to create a global list of Public Registers in each jurisdiction, to enable easier confirmation of market participants' adherence status at a global level.

Initiatives by Central Banks

Central banks have played an important role in the creation of the Global Code. Therefore, central banks are expected to demonstrate their commitment to promoting and maintaining good market practices, except where this would inhibit the discharge of their policy functions. Central banks will also expect that their regular FX trading counterparties adhere to the principles of the Code.

Such adherence to the Global Code by central banks themselves and their expectation for adherence by regular FX counterparties are considered to serve as impetus for wide-spread adherence by market participants.

Linking Code Adherence to FXC Membership

FXCs of major financial centers, including the Tokyo FXC, have released a joint statement supporting widespread adherence upon the Global Code's publication[9]. In addition, a number of FXCs have decided to publicly link membership of the FXC with adherence to the Code, in a manner consistent with laws and regulations in each jurisdiction.

Initiatives by Infrastructure Providers to Promote Adherence

Market infrastructures such as electronic trading platforms and settlement systems, to which a number of market participants are members play a vital role in FX transactions. Several infrastructure providers who participated in the MPG, upon suggestion from the

FXWG, have voiced support for the Global Code. Some infrastructure providers are considering including references to the Code in their rulebooks. If this is realized, adherence by an even wider range of market participants could be expected.

Future Tasks of the Global Code: GFXC to Promote Adherence and Maintain the Global Code

The FXWG has been terminated following the completion of the Global Code, but it is important to maintain the Code's effectiveness in light of future structural evolution of the FX market and changing behavior of market participants.

There has been an association of FXCs of eight major financial markets including Tokyo. Eight FXCs from other jurisdictions have joined the association, which has now been reestablished as the Global FX Committee (GFXC) comprising central banks and private market participants. The GFXC, serving as an international forum on FX trading practices, will be tasked with the role of promoting adherence to the Global Code as well as maintaining and updating its contents[10].

With regards to maintaining and updating the Global Code, the GFXC will regularly assess market developments such as emerging trading methods, and will consider a comprehensive review if necessary. In conducting such a review, comments from private market participants will be sought through FXCs in each jurisdiction in a manner similar to the Code's drafting process.

The GFXC also plans to monitor the success of the Global Code. By conducting surveys, the GFXC will measure awareness of the Global Code among market participants, their commitment to the principles of the Code, and the pace of implementation of the Code. The GFXC will review the results of the survey, which will inform the discussions and could serve as an input to the regular assessment for necessary changes to the Code. At the moment, the surveys are planned to take place annually, with the first survey to be conducted shortly after the publication of the Global Code.

In addition, central banks will also assess the effectiveness of the Global Code in parallel with GFXC initiatives. In 2020, approximately three years after the launch of the Code, BIS Markets Committee will collaborate with the GFXC to conduct an assessment on issues such as the breadth of adoption of the Code, the effectiveness of adherence mechanisms, and the impact of improved behavior in the market on market functioning.

Initiatives by the Tokyo FXC

The Tokyo FXC, which comprises the Bank of Japan, private financial institutions, and other entities, has undertaken initiatives including the promotion of sound market practices in the Tokyo FX market.

The Tokyo Code of Conduct, created by the Tokyo FXC and which has traditionally governed the Tokyo FX market, will be replaced by the Global Code. To address practices specific to the Tokyo market, such as "Same Day Exchange Quotation" created by individual financial institutions, the Tokyo FXC has issued a set of local standards to complement the Global Code.

In addition, the traditional regional Code of Conduct for the Tokyo market was mainly written for the sell-side, but the Global Code applies to the buy-side as well. To this end, the Tokyo FXC has set up a "Buy Side Sub-Committee" to discuss matters concerning the FX market, including the Global Code, and will work to enhance communication with a wider range of market participants.

Upon the release of the Global Code, the Tokyo FXC has released the Japanese translation[11] of the Code and is reaching out to market participants to provide and exchange information. Further, the Tokyo FXC plans to run a Public Register for the Tokyo market, and financial institutions and other entities to which FXC members belong[12] will commit to Code adherence as well as seek commitments from their counterparties.

Through these initiatives, the Tokyo FXC plans to facilitate Code adherence and promote demonstration of commitments of adherence from a wide range of market participants in the Tokyo market.

Looking Forward

To central banks, a well-functioning market is important as it carries crucial information regarding market participants' views on economic and financial conditions, and also plays a vital role for transmission of its policy[13]. In this regard, central banks have expectations for the realization of a robust, fair, liquid, open, and appropriately transparent FX market which the Global Code aims to achieve.

The Global Code does not override laws and regulations; voluntary adherence by market participants will be the key to its success. To foster voluntary adherence by market participants, it is important to create an environment that motivates market participants to adhere to the Code. It would be vital in this regard to effectively make use of a variety of adherence mechanisms as well as to maintain and enhance momentum for widespread adherence.

The Bank of Japan expects a wide range of market participants to recognize, understand, and adhere to the Global Code for the realization of the Code's objectives. From this standpoint, the Bank will continue to work closely with other central banks and private market participants through the GFXC and the Tokyo FXC to support initiatives to ensure the soundness of the FX market.

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[1] According to the "Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity" conducted by the BIS, electronic trading accounted for over 50% of total turnover in the global foreign exchange market in 2016, up from around 40% in 2010. For details on the forms of electronic trading and changes in the structure of the foreign exchange market brought about by the expansion of electronic trading, see Koga and Takeuchi,"Gaikokukawaseshijou ni okeru torihikino kousokuka/jidouka: shijoukouzou no henka to arata na ronten" (High-speed and Automated trading in the Foreign Exchange Market—Changes in Market Structure and New Issues to be Addressed) <Available only in Japanese>, Bank of Japan Review Series, 2013-J-1, January 2013, and Ou, Takada, and Sugayama, "Saikin no gaikokukawaseshijou no kouzouhenka" (Recent Structural Changes in the Foreign Exchange Market) <Available only in Japanese>, Bank of Japan Review Series, 2014-J-5, July 2014.

[2] For details on cases of misconduct, see Uemae, Ohkawa, and Inoue, "Gaikokukawaseshijou no shinraiseikoujou ni muketa initiative -- Code of Conduct (koudoukihan) no seibi ya kokusaitekichouwa no torikumi" (Initiatives to Enhance Trust in the Foreign Exchange Market -- Efforts to Formulate and Coordinate Codes of Conduct) <Available only in Japanese>, Bank of Japan Review, 2015-J-9, June 2015.

[3] The FSB Report is available at the following website.

(http://www.fsb.org/2014/09/r_140930/)

[4] "Global Preamble" is available at the following website.

(http://www.fxcomtky.com/coc/index_e.html)

For details on the work to strengthen the Code of Conduct with the aim of enhancing confidence in the foreign exchange market, see Uemae, Ohkawa, and Inoue (2015) (footnote 2) and Matsushima, Ohkawa, and Inoue "The Global Code of Conduct in the Foreign Exchange Market -- For sound development and effective functioning of the Foreign Exchange Market --," Bank of Japan Review, 2016-E-6, June 2016.

[5] The FXWG is composed of central banks in eight jurisdictions, who have brought forward international collaboration on the Global Code (Reserve Bank of Australia, Bank of Canada, Bank of England, European Central Bank, Hong Kong Monetary Authority, Bank of Japan, Monetary Authority of Singapore, Federal Reserve Bank of New York), as well as Central Bank of Brazil, State Administration of Foreign Exchange (China), Bank of France, Reserve Bank of India, Bank of Korea, Bank of Mexico, Sveriges Riksbank, Swiss National Bank.

[6] The MPG is composed of a wide range of market participants, including sell-side (financial institutions), buy-side (institutional investors, fund managers and corporates), market infrastructure providers, and industry groups. Its members are from: ACI Financial Markets Association International, Airbus Group, Axa Investment Managers, Banco Itaú BBA, Banco Ve por Más, Barclays, BATS Global Markets, BlackRock, BNP Paribas, China CITIC Bank, China Foreign Exchange Trade System, Citi, CLS Bank International, DBS Group Holdings and DBS Bank, Deutsche Bank, Eaton Vance, EBS Broker Tec, Ericsson, Fifth Third Bank, Industrial Bank of Korea, JP Morgan, LGIM Legal & General Investment Management Ltd, MarketFactory, Inc, Millennium Global, Mizuho Bank, Moore Capital, Norges Bank Investment Management, PGGM, Rolls-Royce, Royal Bank of Canada, SEB, Seoul Money Brokerage Services, Inc, Société Générale, Standard Chartered Bank, State Bank of India, Swiss Re, Tata Consultancy Services, The Bank of Tokyo-Mitsubishi UFJ Ltd, The Hongkong and Shanghai Banking Corporation Limited, Thomson Reuters, UBS Investment Bank, Virtu Financial, Westpac Banking Corporation, and XTX Markets.

[7] The Global Code is available at the following website.

(http://www.globalfxc.org/)

[8] HFT (High Frequency Trading) refers to trading strategies that make use of algorithms to conduct automated, high speed, and high frequency transactions. For details, see Koga and Takeuchi (2013) (footnote 1) and Ohkawa, "Gaikokukawaseshijou ni okeru hedge fund: shijoukouzou ya kakakukeisei heno implication" (Hedge Fund in the Foreign Exchange Market: Implications for Market Structure and Price Formation) <Available only in Japanese>, Bank of Japan Review, 2015-J-1, January 2015.

[9] The joint statement is available at the following website.

(http://www.fxcomtky.com/coc/index_e.html)

[10] Please see the following website for information on the GFXC.

(http://www.globalfxc.org/)

[11] The Japanese translation of the Global Code is available at the following website.

(http://www.fxcomtky.com/coc/index.html)

[12] The Tokyo FXC is formed by "individuals" who belong to financial institutions and other entities in the Tokyo FX market.

[13] See Nakaso "Developing a Global Code of Conduct for the Foreign Exchange Market -- Opening Remarks at the BIS FXWG-MPG Meeting in Tokyo," February 2016.

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