MEMO# 29183

July 20, 2015

UK Fair and Effective Markets Review

[29183]

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TO: FIXED-INCOME ADVISORY COMMITTEE No. 23-15
EQUITY MARKETS ADVISORY COMMITTEE No. 12-15
ICI GLOBAL CAPITAL MARKETS UNION TASK FORCE
ICI GLOBAL EXCHANGE TRADED FUNDS COMMITTEE No. 5-15
ICI GLOBAL REGULATED FUNDS COMMITTEE No. 39-15
ICI GLOBAL STEERING COMMITTEE No. 14-15
ICI GLOBAL TRADING & MARKETS COMMITTEE No. 36-15
INTERNATIONAL COMMITTEE No. 38-15
INTERNATIONAL OPERATIONS ADVISORY COMMITTEE No. 19-15 RE: UK FAIR AND EFFECTIVE MARKETS REVIEW

The UK hosts a substantial share of Fixed Income, Currency and Commodities (FICC) transactions globally. [1] Recently, several high profile scandals have undermined public confidence in FICC markets. These have included: (i) the manipulation of LIBOR in 2012, prompting the Wheatley Review [2]; (ii) the manipulation of FX benchmarks by several UK banks between 2008 and 2013, resulting in the FCA and other regulators levying fines at the end of 2014 [3]; and (iii) the misselling of interest rate hedging products. [4]

To restore and strengthen confidence in the FICC markets, the UK Government, Bank of England and Financial Conduct Authority (the “Authorities”) announced the Fair and Effective Markets Review (FEMR) in June 2014. [5] In a subsequent consultation in October 2014, [6] the Authorities identified common themes from the scandals as well as providing a description and review of the FICC markets (“FEMR Consultation”). On 10 June 2015, the final FEMR report was published containing policy recommendations. [7]

FEMR Consultation

In the FEMR Consultation, the Authorities raised questions as to how FICC markets could be made “fair and effective”, including through changes to their micro-structure, enhancements to competition and market discipline, and raising standards of market practice. The consultation attracted nearly 70 responses [8] including significant input from an independent Market Practitioner Panel (MPP). The MPP is made up of senior representatives of internationally-active sell-side and buy-side firms, market infrastructure providers, major corporate users of financial markets and independent members, and chaired by Elizabeth Corley, CEO of Allianz Global Investors. [9]

FEMR Policy Recommendations

The final report was published on 10 June 2015. The report made several recommendations, shaped around the following four key principles:

- Individuals active in FICC markets should be more accountable for their actions;
- Firms active in FICC markets should take greater collective responsibility for developing and adhering to clear, widely understood and practical standards of market practice, in regular dialogue with the authorities;
- The UK authorities should extend the regulatory perimeter, broaden the regime holding senior management to account and toughen sanctions against misconduct; and
- International authorities should collaborate to raise standards in global FICC markets.

The report recommended 21 items in the following 6 areas, including actions to improve conduct in FICC markets and principles to guide a more forward-looking approach:

- Raise standards, professionalism and accountability of individuals;
- Improve the quality, clarity and market-wide understanding of FICC trading practices;
- Strengthen regulation of FICC markets in the United Kingdom;
- Launch international action to raise standards in global FICC markets;
- Promote fairer FICC market structures while also enhancing effectiveness; and
- Promote forward-looking conduct risk identification and mitigation.

Detail is provided in annex (i) and (ii) of this memo.

Industry Response

The buy-side and sell-side have acknowledged the need to enhance confidence and rebuild trust in FICC markets. Some, including the independent MPP, challenged the premise that FICC markets are fundamentally broken, or in need of significant structural reform.

Several asset managers suggested that recent market misconduct had been due to individual conduct issues and that the conduct issues had been exacerbated by weaknesses in the design and governance of market structures and in the governance of organisations. Several industry associations, including the Investment Association [10], underscored the need for co-ordination between regulations and an appropriate balance among national, regional and international regulation. Many responses [11] addressed the issue of market liquidity, including the impact of enhancing pre-trade and post-trade transparency. Most responses supported an effective and proportionate transparency framework but, in respect of pre-trade transparency, underscored the need for initiatives (e.g. MIFID II) to be carefully calibrated to protect liquidity.

Implications for funds

The FEMR's policy recommendations are likely to have implications for funds and asset managers operating within and outside the UK. Several announced reforms will impact funds and asset managers in the UK. For instance, as announced by George Osborne [12] and Mark Carney [13] in June, the FCA's accountability regime for individuals will be extended to senior managers active in wholesale FICC markets, including asset managers. [14]

The FEMR's policy recommendations also are likely to have implications at EU level. For example, this will be the case for recommendations affecting EU dossiers that are subject to implementation, including MiFID and EMIR (e.g. concerning fixed income market transparency and liquidity). Furthermore, in the final report, the Authorities acknowledge the global nature of FICC markets and fact that several recommendations will require international discussion and co-ordination, including with the Financial Stability Board (FSB), the International Organization of Securities Commissions (IOSCO), and other national and international authorities. As such, the FEMR may have implications outside the EU.

Annex (i) – Near-term actions to improve conduct in FICC markets

1. Raise standards, professionalism and accountability of individuals

    a. Develop a set of globally endorsed common standards for trading practices in FICC markets, in language that can be readily understood, and which will be consistently upheld;
    b. Establish new expectations for training and qualifications standards for FICC market personnel, with a requirement for continuing professional development;
    c. Mandate detailed regulatory references to help firms prevent the 'recycling' of individuals with poor conduct records between firms;
    d. Extend UK criminal sanctions for market abuse for individuals and firms to a wider range of FICC instruments; and
    e. Lengthen the maximum sentence for criminal market abuse from seven to ten years' imprisonment.

2. Improve the quality, clarity and market-wide understanding of FICC trading practices

    a. Create a new FICC Market Standards Board with participation from a broad cross-section of global and domestic firms and end-users at the most senior levels, and involving regular dialogue with the authorities, to:

       – Scan the horizon and report on emerging risks where market standards could be strengthened, ensuring a timely response to new trends and threats;
       – Address areas of uncertainty in specific trading practices, by producing guidelines, practical case studies and other materials depending on the regulatory status of each market;
       – Promote adherence to standards, including by sharing and promoting good practices on control and governance structures around FICC business lines; and
       – Contribute to international convergence of standards.

3. Strengthen regulation of FICC markets in the United Kingdom

    a. Extend the UK regulatory framework for benchmarks to cover seven additional major UK FICC benchmarks (N.B. already accepted and implemented by HM Treasury on 1 April 2015);
    b. Create a new statutory civil and criminal market abuse regime for spot foreign exchange, drawing on, among other things, work on a global code;
    c. Ensure proper market conduct is managed in FICC markets through monitoring compliance with all standards, formal and voluntary, under the Senior Managers and Certification Regimes;
    d. Extend elements of the Senior Managers and Certification Regimes to a wider range of regulated firms active in FICC markets; and
    e. Improve firms' and traders' awareness of the application of competition law to FICC markets.

4. Launch international action to raise standards in global FICC markets

a. Agree a single global FX code, providing: principles to govern trading practices and standards for venues; examples and guidelines for behaviours; and tools for promoting adherence. The Review strongly welcomes the recent announcement by central banks to work towards those goals;
b. As part of that work, improve the controls and transparency around FX market practices, including 'last look' and time stamping;
c. Explore ways to ensure benchmark administrators publish more consistent self-assessments against the IOSCO Principles, and provide guidance for benchmark users; and
d. Examine ways to improve the alignment between remuneration and conduct risk at a global level.

Annex (ii) - Principles to guide a more forward-looking approach to FICC markets:

5. Promoting fairer FICC market structures while also enhancing effectiveness, through:

   a. Improving transparency in ways that also maintain or enhance the benefits of diverse trading models, including over-the-counter;
   b. Promoting choice, diversity and access by monitoring and acting on potential anti-competitive structures or behaviour; and
   c. Catalysing market-led reform held back by private sector co-ordination failures.

6. Forward-looking conduct risk identification and mitigation, through:

   a. Timely identification of conduct risks (and mitigants) posed by existing and emerging market structures or behaviours;
   b. Enhanced surveillance of trading patterns and behaviours by firms and authorities; and
   c. Forward-looking supervision of FICC markets.

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endnotes

[1] The FEMR estimates suggest that the UK handles c. 38% and c. 42% of global FX spot and FX swap transactions by daily turnover.

[2] The Wheatley Review of LIBOR: final report, September 2012, available from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/191762/wheatley_review_libor_finalreport_280912.pdf

[3] FCA fines five banks £1.1 billion for FX failings and announces industry-wide remediation programme, Press release, 12 November 2014, available from http://www.fca.org.uk/news/fca-fines-five-banks-for-fx-failings

[4] Interest Rate Hedging Products, FCA, available from http://www.fca.org.uk/consumers/financial-services-products/banking/interest-rate-hedging-products

[5] Joint News Release with HM Treasury and the Financial Conduct Authority – Chancellor

of the Exchequer announces Fair and Effective Markets Review, 12 June 2014, available from http://www.bankofengland.co.uk/publications/Pages/news/2014/089.aspx

[6] How fair and effective are the fixed income, foreign exchange and commodities markets?, Consultation document, October 2014, available from http://www.bankofengland.co.uk/markets/Documents/femr/consultation271014.pdf

[7] Fair and Effective Markets Review Final Report, 10 June 2015, available from http://www.bankofengland.co.uk/markets/Documents/femrjun15.pdf

[8] Fair and Effective Markets Review consultation responses, available from http://www.bankofengland.co.uk/markets/Pages/femrresponses.aspx

[9] Fair and Effective Markets Review, Market Practitioner Panel website, available from http://www.femr-mpp.co.uk/

[10] http://www.bankofengland.co.uk/markets/Documents/femr/tia.pdf

[11] http://www.bankofengland.co.uk/markets/Documents/femr/aam.pdf

[12] Mansion House 2015: Speech by the Chancellor of the Exchequer, 10 June 2015, available from https://www.gov.uk/government/speeches/mansion-house-2015-speech-by-the-chancellor-of-the-exchequer

[13] Building real markets for the good of the people, Speech by Mark Carney, Governor of the Bank of England, Mansion House, 10 June 2015, available from http://www.bankofengland.co.uk/publications/Documents/speeches/2015/speech821.pdf

[14] This regime requires senior managers to have clearly defined responsibilities including training, certifying and monitoring “material risk takers” they supervise.
