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Fair and Effective Markets Review
Bank of England
Threadneedle Street
London EC2R 8AH

(submitted via email to FEMR@Bankofengland.co.uk)

Re: Fair and Effective Markets Review Consultation October 2014: How fair and effective are the fixed income, foreign exchange and commodities markets?

Introduction

The Bank of New York Mellon Corporation (BNY Mellon) is a global custody and trust company dedicated to helping its clients manage and service their financial assets throughout the investment lifecycle. As one of the world's largest investment services and investment management firms, BNY Mellon welcomes the opportunity provided by the Bank of England, Financial Conduct Authority and H.M. Treasury (together, the Authorities) to respond to the Fair and Effective Markets Review consultative document (Consultation) titled "How fair and effective are the fixed income, foreign exchange and commodities markets?".

BNY Mellon operates in Europe through: (i) branches of The Bank of New York Mellon (a New York state chartered bank) and (ii) directly established and duly authorised subsidiaries established in certain EU jurisdictions and branches of those entities operating in core EU member states. BNY Mellon provides services to clients and end-users of financial services globally. It is accordingly keenly interested in ensuring that financial markets operate fairly, effectively and consistently globally and that common standards enable playing fields to be kept level.

Executive Summary

BNY Mellon fully supports the objective of the Fair and Effective Markets Review (FEMR) to ensure that fixed income, foreign exchange and commodities (FICC) markets remain fair and effective in their operation and welcomes this initiative to seek industry's views on the fairness and effectiveness of the FICC markets.

In responding to this Consultation, we have worked with several industry associations, in particular the Association for Financial Markets in Europe (AFME) and the British Bankers Association (BBA).

Although we largely agree with the responses provided by AFME and the BBA, BNY Mellon wishes to submit its own response to this Consultation to highlight certain points given its unique perspective as a global custodian and the wide-ranging nature of the business activities it covers.

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General Comments

We believe that many of the factors that the Consultation identifies as problematic for fair and effective markets have been addressed by a wide range of recent initiatives. In many cases, these initiatives have either been introduced very recently (e.g. UK regulation of benchmarks) or are in flight such as Dodd-Frank, EMIR, MiFID II, EU Benchmarks Regulation, Senior Managers Regime, certifications, conduct rules and MAD/MAR. Such initiatives will change the way in which the FICC markets operate and will provide the authorities with large amounts of data through transaction reporting from the industry thereby enabling the authorities to monitor the FICC market landscape, identify risks and ensure effective enforcement. Our recommendation is for these initiatives to be fully implemented and embedded and for their impact to be assessed after a period of time prior to determining the need for any further measures.

We fully support the Review's intention for its recommendations to influence the international debate on trading practices and identify incentive structures and practices that will lead to better outcomes for the market as a whole. The FICC market (in particular FX) is a global business. One of the challenges for fair and effective global markets is divergent regional interpretations of high level principles, inconsistent reforms and conflicting rulemaking. It is therefore important that the introduction and implementation of initiatives are coordinated internationally to reduce the risk of market fragmentation and regulatory arbitrage.

With respect to European legislation, co-operation and consistency among regulators should be strengthened to prevent inconsistencies in the implementation and application of European legislation across jurisdictions. In this respect, we would urge the Authorities to consider playing a leadership role in current discussions relating to Capital Markets Union.

It is important to build a fair and balanced environment for all market participants. We encourage the Authorities to collaborate, where appropriate, with the industry to build a market-led framework, including future infrastructure that builds on existing good practices and applies to all market participants (sell-side and buy-side). Appropriate application of measures to all market participants is key for ensuring a level playing field and maintaining of standards given frequent movement of individuals in the market between sell-side and buy-side.

We would welcome more active dialogue between the regulator and regulated to enhance the understanding of market practitioners with respect to the application and interpretation of applicable codes of conduct, regulations and principles particularly for areas requiring greater clarity (e.g. forms of acceptable communication and conflicts of interest).

We would recommend the establishment of an independent industry body comprising market experts that would allow a clearing house or some such other facility for the industry to meet and discuss difficult issues of market practice and that would develop principles, guidelines and case studies to address specific grey areas of conduct within all of the FICC markets. In this context we would suggest that the Market Practitioner Panel would be well placed to act as such body perhaps under the Banking Standards Review Council.

Comments relating to Market Microstructure

An important component of market effectiveness is the continued availability of liquidity that helps achieve efficient allocation of capital in the system. We would therefore recommend that any measures should factor in one of the key underlying purposes of the market maker model of FICC markets which is to facilitate liquidity generation in the system. In this regard, we would recommend that transparency is appropriately calibrated to prevent unintended consequences: increased costs to investors (impacting for example, pension funds) and market makers unable to hedge and unwind their risks, discouraging client trades and reducing liquidity in the market.

FICC markets comprise distinct asset classes and sub-asset classes. We believe that it is important that the individual characteristics of the component FICC markets are considered within context so as to develop an appropriate framework that promotes both effectiveness and fairness.

In this regard, we would express caution against exposing the FX spot market to the same model of existing derivatives regulation for the following reasons:

- Current derivatives regulation has not been designed for the FX spot market and its application to the FX spot market could have the unintended consequences of disrupting established market systems including the effectiveness of the global payments system.

- The FX spot market will be subject to the UK Senior Managers and Certification Regime.

- The FX spot market is likely to be most aptly monitored through a unified, global Codes of Conduct framework based on high-level principles that allow for appropriate regional variances in operational practices.

Comments relating to Conduct

We believe that firms across the industry should hold themselves accountable for strengthening their risk culture and embedding it throughout their organisations. In doing so, we would recommend that firms consider the following:

- The emphasis on "tone from the top" is very important in stressing the need for ethical behaviour. However, we believe that it is equally important that ethics and standards of behaviour are driven from the top and spread throughout the entire organisation so that staff at all levels feels ownership of these principles. Ensuring that the middle management layer is engaged in cascading the "tone from the top" will be instrumental in achieving this.

- We believe that establishing the right governance, accountability and incentives structure is key to creating a sound culture. We also believe that there should be a clear procedure for escalating issues and obtaining guidance. We would also emphasise the need for compensation and other incentives to be aligned with best practice in culture and behaviour. With respect to incentives, we would emphasise that opportunities for employee development and advancement are important incentives in addition to financial incentives.

- Continued education/training and appropriate monitoring are also essential to achieving this aim. In particular, we would recommend a return to more class-room based training with senior management involvement in which "story telling" is used to help provide clarity around "grey areas", illustrate the mechanics for escalating issues and obtaining guidance and demonstrate positive whistleblowing outcomes.

BNY Mellon looks forward to further engagement with the FEMR in regard to this consultation document and any future consultation documents on this topic.

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