The Association of Corporate Treasurers

Comments in response to
How fair and effective are the fixed income, foreign exchange and commodities markets?
October 2014

January 2015

The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. Further information is provided at the back of these comments and on our website www.treasurers.org.

Contact details are also at the back of these comments.

We canvas the opinion of our members through meetings, seminars and conferences, webinars, our monthly e-newsletter to members and others, *The Treasurer magazine*, topic-specific working groups and our Policy and Technical Committee.

1 General

The ACT welcomes the opportunity to comment on this matter.

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2 Introduction

The scope of the FEMR's work is potentially huge and, even after the welcome shaping of the Review set out in the Consultation Document it remains very large.

The ACT comments from the point of view of non-financial – mainly industrial and commercial – users of financial services and financial markets. Financial services firms of various kinds are better placed to comment on many topics in the Consultation document and in these comments we have confined our remarks to a few areas.

The ACT has been pleased to have had the opportunity to discuss the Review with two of the Chairs and with the secretariat several times and, on two occasions, to involve a number of ACT members in those conversations.

The focus of legislation and regulation following the financial crisis of 2007-8 has been twofold: on financial stability and on "getting a grip" on the financial services industry. The industry has been seen as having been a source of instability and of scurrilous behaviour. The impact of the proposed changes on (non-financial-services sector) *users* of markets and financial services – on the industrial and commercial economy – has, on occasion, been somewhat lost.

We would make the point that we think it usually important to look at each market, product, on its own merits. It is usually inappropriate to generalise across FICC markets and apply a solution considered effective in one area to another without adequate study and reflection[1].

We think that the Review is very important and very timely.

3 Principal points

- Non-financial (commercial and industrial) companies and other nonfinancial sectors (e.g. universities and colleges, charities, regional/local governments, police authorities, hospital trusts, etc.) do want to use available, honest, open, reliable and fair markets. They use them for all the purposes considered in the Consultation Document and additionally, in the case of commodities, for commodity acquisition for use. But, overwhelmingly, not for speculation[2].

- Fairness and effectiveness require the idea of proportionality. Non-financial market users are a small part of most FICC markets. Regulation of and oversight processes for financial services applied to non-financial services organisations is often disproportionate, costly, and discouraging of real economy activity.

[1] We note, for example, that in the introduction to Section 5 of the Consultation Document, in 5.1, Market microstructure" 5.1.1, ""Overview", seems not to take an overview but focuses on cash debt markets and the application of equity type structures and rules – that may be inappropriate to debt markets and may be extended even more widely.

[2] Firms in a small number of industries, notably energy and primary product industries, may have a unit that extensively trade the particular commodity. This is usually a separately incorporated and often a regulated entity. Our comments in response to the Consultation Document relate to the mainstream, treasury activities of non-financial firms.

- Non-financial clients are unlikely materially to contribute to “market discipline”. Abuse by a bank in one area of FICC is unlikely to prompt a non-financial to change materially its attitude to the institution. The activity directly affected is likely to be only a part of an often very broad relationship. The disruption and cost of re-directing business, particularly if it involves operating rather than treasury units of the firm, is high.

- Standardisation of corporate bond issuance raises many questions and is not suitable for a wide-ranging consultation. If interesting, it should be the subject of a particular consultation with a long consultation period.

4 Response to consultation questions

In the sub-headings below, we have summarised the questions, not repeated them in full.

4.1 Question 1: Definition of ‘fair and effective”?

1.1. The opportunity for the FEMR to stand back a little and take account of effectiveness and fairness, doubtless from a broad point of view of industry players but also (and for us, significantly) from the point of view of its customers and counterparties must not be lost.

1.2. Regarding “effective”, we agree with the concept of enabling investment, funding and risk transfer. These are multi-tiered ideas. And we don’t think they are very separable.

1.2.1. Those using FICC markets whose investments may be enabled may be principals or intermediaries. But intermediaries, such as investment funds or pension managers, or banks that have taken on an exposure from a client and is looking to lay it off, may look for some of these purposes somewhat like principals.

The market needs to be effective for all participants – not just the “end-users, borrowers and end-investors” referred to in 5 of Section 3 of the consultation. If it is ineffective for intermediaries when in the role “looking like principals” find it ineffective, they will undoubtedly pass on the risks /costs to the “end-users, borrowers and end-investors” – or will be unwilling to deal with them: totally ineffective.

1.2.2. And those facilitated investments may be financial or real.

A pension fund may be simply buying bonds, or using fx markets to enable that or investing in shares of a foreign company and using fx markets as an enabler and for associated risk transfer. An engineering company may be re-equipping a factory and issuing bonds, using foreign exchange, interest rate and commodity markets as enablers and risk-transfers in doing that.

1.2.3. Importantly, some market participants may be using FICC products themselves as investments – not only bonds, but interest rates, foreign exchange and commodities (cash and derivatives) can be seen as asset classes in themselves. And end-users of commodities can use the markets for procurement as well as for hedging.

1.2.4. And everyone can use these markets for risk transfer – however the risks arise.

It is important that risk is transferred to those better able to manage or distribute or hold the risk. (See 1.2.6, below.) The approach in financial regulation since the crisis has often seemed to be to transfer financial risk to those least able to manage it – often non-financial companies, clients of the financial services industry.

1.2.5. Of course, a market without competitive prices would be a poor show.

1.2.6. There is, however, an additional effectiveness criterion we would add.

These markets, transferring risk, can directly have effect towards financial stability or financial instability. And they have an additional role in slowing or speeding the onset and transmission of crises, panics etc. (See comment on risk transfer, 1.2.4, above.)

So we would add the characteristic of not contributing to financial instability or, less attractively, of contributing to financial stability. We think that goes beyond or is additional to the "robust infrastructure" criterion.

1.3. Regarding fairness, the characteristics set out are attractive, though we would qualify particularly the "transparency" characteristic particularly as regards pre-trade transparency.

1.3.1. As public perception of "unfairness" is a concern in the Review, where the interface is between transparency and "education" of those affected is important. Sale of FICC derivatives, interest rate hedges, by banks in the UK was perceived as unfair in its effects. Disclosure of contractual terms, pricing, etc. etc. is part of transparency. What the effect of the product is – what the product is, in reality – is that a matter of transparency or of education? Whose responsibility it is depends on the answer.

And who carries not the risk of the contract entered into but the residual risk of market failure or infrastructure failure or counterparty failure again may be transparency or education.

The answers come down to structural issues and, especially to the responsibility, or lack of it, of the sales arm of the financial services firm/market/whatever to disclose prior to establishing a sales relationship and of the users to educate themselves in advance. Clarity here might improve fairness perception.

[The ACT, as a seller of financial education should probably declare an interest here.]

1.4. Fairness and effectiveness require the idea of proportionality.

1.4.1. Proportionality has many different applications.

Achieving small improvements in one of the characteristics determining fairness and effectiveness at great cost or having the effect of substantially closing down a thriving market valued by its users would clearly be disproportionate.

We would draw attention to another area requiring a proportionate approach.

Applying financial services oriented regulation/rules to non-financial services users may also be disproportionate.

Clearly some such regulations will extend to such users. Examples would be regarding market abuse (a company with relevant securities procuring or counselling insider dealing, failure to disclose required information under transparency rules or falsifying information, etc.), failure to comply with prospectus requirements, some market manipulation rules, etc..

But many provisions affecting FICC markets do not need to extend to clients. Too many do. For example the European EMIR Regulation that affects FICC markets imposes reporting requirements on non-financial clients of financial services firms. Non-financial clients account for small proportions of most EMIR FICC markets. The reporting involves expensive system changes or delegation to other companies but with a requirement to monitor and verify such reporting, including paying subscriptions to repositories as well a licencing Legal Entity Identifiers, all of which cost money. All of this is a burden, especially on smaller clients. And all such clients are generally accepted as non-systemic in themselves, being more granular and less correlated than financial services firms.

Application of sensible proportionality would take away many of the spill-overs to the non-financial services users.

Accordingly we would recommend that the excellent notional analytical framework of the Table A on page 5 of the consultation document be slightly modified notionally to split at least the “Firms” column into “Financial-services Firms” and “Non-financial-services Firms” – here using firms very widely to include charities, colleges, etc., and even small Chartered bodies such as the ACT that itself makes very modest use of FICC markets.

4.2 Question 2: Most important in recent FICC market abuses of the six themes of Table A?

2.1. Our members are not experts in the internal governance structures and incentives etc. of financial firms involved in recent FICC abuses.

2.2. The ACT has been a supporter of the NIPs Code since its predecessor’s inception under the auspices of the Bank of England. Following the Bank of England’s encouragement of LIBOR governance changes in 2008, the ACT nominated a member of the BBA’s Foreign Exchange and Money Market Committee that carried out some roles in relation to LIBOR. The ACT’s Chief Executive was represented on the Hogg Committee that selected ICE Benchmark Administration Limited (IBA) to be Administrator of LIBOR in successor to BBA. The ACT nominates one member of the IBA’s Independent LIBOR Oversight Committee. So bank conduct in FICC has been of interest, however.

2.3. Conduct seems to us the most important grouping of themes. But we would stress an aspect not explicitly highlighted in Table A.

2.3.1. Conduct in an organisation is only partly a reflection of the formal structures. It is also a reflection of the character of the organisation concerned and of the people working there. And while an organisation would seek to have consistency across all its units and sub-divisions, this is, in practice very difficult to achieve.

2.3.2. An early effort in this field was (now Sir) Adrian Cadbury's booklet, *The Character of the Company*, issued to all managers at Cadbury and later at Cadbury Schweppes (CS) from the 1950s to the early 90s. (One of the authors of these comments was given a copy on joining CS in 1986.)

The enemy of such efforts is the tendency of units in an organisation form silos – self-referential and shielded from the view of others (would be overseers or other organisational units within the firm dealing with the silo concerned. Such silos can be deliberately created or tend to happen "naturally" when a small group of subject specialists work closely together, perhaps initially serving the rest of the firm, eventually becoming partially self-serving. If the unit appears (from outside) to be generally performing well for the firm, it can be undisturbed. And it may become able to intimidate other units within the firm.

Breaking up effective teams is not the first thought of most senior managers. Accordingly, such silos can subsist over very long periods.

It is easy to see how this happens within a financial services firm where a few product specialists begin to work in a bubble of their own – the unit manager often having effective sole decision making on recruitment to the unit and on the performance reviews of all the workers in it.

And where, in day to day relationships, the dysfunctional but apparently effectively performing silo's members can identify others such in other parts of the firm, the industry or among their own clients or suppliers, poor behaviour can become more rewarding and self-sustaining. That the behaviour may be contrary to regulation (including competition regulation in cross-firm activity) may not influence behaviour as no one expects to be "caught".

In the extreme, only concerted and severe action by a high percentage of employers in the field concerned can begin to undo the mischief. This may apply in the circumstances considered in 4(c) of 5.5 of the Consultation.

2.3.3. We think that the phenomena discussed above were seen in the FICC scandals recently.

The six themes of Table A all have aspects that are important for maintaining effectiveness and fairness of FICC markets. But the key is the management of small and specialist teams whose skills may be scarce and whose personal knowledge and experience and contacts in the industry and with clients are important factors for success. We think it is in this field that financial services firms are likely to have greatest difficulty in adapting to new requirements, market conditions and client expectations.

The issues raised occur in many fields including the military. We are sure there is a literature related to that and make no specific recommendations ourselves.

4.3 Question 3: Barrier or digital options?

3.1. Use of barrier options and similar "knock-in" or "knock-out" products by non-financials is likely to be confined to the largest non-financials – both because non-financials are less likely to have risks to hedge that match the payout profiles and because the effort required to explain them to boards, auditors, etc. and to monitor

and manage them can rarely be supported.

That their use in some of the products sold to small firms in the UK resulted in material pay-outs by the banks for mis-selling is entirely unsurprising. That dealers may be able to nudge prices to "defend" or to trigger them further discourages non-financial corporate use.

4.4 Question 4: Most important in recent FICC market abuses of the six themes of Table A?

4. No comment.

4.5 Question 5: Fixed income: electronic trading venues?

5. No comment

4.6 Question 6: Standardisation of corporate bond issuance?

6.1. Standardisation of bond issuance may offer conveniences to investors.

6.1.1. Standardisation of issuance processes may also be a convenience for issuers, or neutral to them. Standard documentation types, standard timetables, etc. are in this category.

In looking at the development of a UK/European private placement bond/loan market, the ACT has urged such an approach[3] and has participated in and welcomed the démarches by the Loan Market Association and the Euro PP Working Group published in January 2015 on model framework documentation and that by the Pan-European Private Placement Working Group (coordinated by ICMA) due in February 2015 regarding the whole issue process.

Importantly, the actual documentation will be developed from the model in a customised way for each issuer and each issue – specific wordings but in a relatively standardised framework.

6.2. Issuers are likely to oppose more substantive standardisation. This is not a topic for a wide-ranging enquiry but needs to be the subject of a specific consultation with a quite long consultation period.

6.2.1. It is important to recognise that non-financial issuers are much more varied (and there are potentially a great many more of them) than of sovereign/sovereign related issuers and large financials. Terms and conditions for different borrowers will therefore vary significantly, even between issuers in the same credit category and/or industry. And an issuer may have different requirements from different issues – even similar issues at different times or into different markets

6.3. Rhetoric on standardisation is often about the secondary market. There never has been much of a secondary market and today, with banks having to hold greater capital against inventory and probably unable to do proprietary trading, a

[3] See for example the Report of the PP15+ working group on developing a UK Private Placement market (http://tiny.cc/smebqx) that the ACT Chaired as recommended by the Breedon report of March 2012 (Boosting Finance Options for Business, http://www.bis.gov.uk/businessfinance).

secondary market seems extremely unlikely – see 7.1.2, below.

6.3.1. Comments on question 7 below are relevant to this question.

4.7 Question 7: More transparent bond issue process?

7.1. As with question 6, we think this should be the subject of a separate consultation. Comments on question 6 above have relevance to this question.

7.1.1. Issuers have an interest in the character of and their relationship with the holders of their bonds and allocation is not solely a matter of price. If a bond is to be widely distributed – as with a retail bond – that will influence many features of the issue.

7.1.2. Non-financial issuers are very content with "buy and hold" investors, while recognising that the *possibility* of sale/transfer may be important for an investor. They recognise that that means a small or non-existent secondary market. While lack of (an active) secondary market may be inconvenient for issuers wanting to do small buybacks, few would want to change that.

7.1.3. As with corporate bank loans, bond terms and conditions contracts can be seen as incomplete and lenders have incomplete information about the borrower. From the issuer's point of view, that means that who is lending is important unless are there no or close to no conditions on the borrowing. If there are conditions, borrowers will need to put conditions on suitable buyers and transferees – as is normal in syndicated loans and private placements.

7.1.4. Bond issuance nowadays progresses by book building. Banks have no immediate incentives to secure the best pricing or the best conditions for the issuer.

7.2.1. Regarding bond issuance in general, it has to be kept in mind that companies are already restricted in when they can issue bonds due to periods prior to announcements (annual, half-yearly, quarterly) being prohibited. (This may be eased slightly by the recent relaxation following the recommendation of John Kay's review.)

4.8 Question 8: FX: internalisation and last look?

8. No comment

4.9 Question 9: FX: netting and execution facilities?

9. No comment

4.10 Question 10: Commodities: transparency?

10. No comment

4.11 Question 11: FICC regulatory measures?

11.1. Changes to these markets that make use by non-financials more difficult or more expensive would be regretted. Particularly, if they were introduced by one

jurisdiction or group of jurisdictions, that would be a great incentive for internationally operating firms to move their FICC activity to more congenial locations.

Accordingly, if such changes were contemplated, they would need to be introduced internationally.

11.2. Companies tend to be very practical. They are reluctant to pay for or be inconvenienced by changes that lead theoretically to better outcomes but in practice make little difference. Financial services firms may see margins in the odd basis point or even fraction thereof – because of their leverage or volume. That enables them to carry high systems costs to support that. Non-financials are usually dealing in smaller volumes and are not in FICC markets to make money but to facilitate their underlying business and lay-off risks they are unwilling to hold. Increased systems or administrative costs are unlikely to be recovered and must be absorbed: bad news.

4.12 Question 12: Conflicts of interest and confidential information?

12. No comment

4.13 Question 13: Conflicts of interest – reducing vulnerabilities?

13. No comment

4.14 Question 14: Competition, fairness and effectiveness – concentration?

14.1. See comments re Question 17, below.

4.15 Question 15: Promoting competition?

15. No comment

4.16 Question 16: Alternative market structures and competition?

16. No comment

4.17 Market discipline in key FICC markets

17.1. We do not believe that non-financial companies, users of FICC markets, have material influence on market/counterparty discipline.

17.1.1. There are a number of reasons for this – only partly associated with the often small volume in the sector of the market concerned of any particular company as client.

17.1.2. A non-financial (often dealing with a bank) is likely to deal with the FICC counterparty across a wide field of products and services. Switching providers can require a long and administratively inconvenient process. The costs are unlikely ever to be recovered. And switching may give no ultimate reassurance if it is

thought "everybody could be doing it."

If the changes affect operation units within the firm – not just, for example, the central treasury, the difficulties are multiplied manyfold.

17.1.3. With many banks, the wide relationship will mean that many products are "priced for the relationship" – above or below the apparently normal market price. Stopping using one product can be disruptive[4].

Indeed, smaller non-financial firms may, in practice, be unable to switch providers because of "the tie" (illegal in the US[5]) of lending to use of ancillary services. (See comment in response to Question 18, below.)

Where banks have taken charges over assets, smaller firms are probably unable to move part of their financial business – FICC in this case – to another institution because their credit standing is unlikely to support that.

17.1.4. For larger companies' FICC activities, the universe of large banks with the willingness to take on the large credit exposures that may be entailed is tending to get smaller. In any case, a large transaction may have to be spread across 2 or 3 banks – both because of the banks' appetite and the client's restriction on exposure to particular banks[6]. The firm will be using a number of banks all the time. It may be able to drop one or two banks, but if several are said to have abused their position, firms are impotent.

17.1.5. Since the 2007-8 crisis, non-financials find it difficult to get sufficient banks to quote on commodities trades. Ceasing to deal with a counterparty because of abuse is not a realistic opportunity. To quote one treasurer ""We may have less trust in banks, but where else do you go?" – and the answer in derivatives is not exchange traded derivatives because non-financials are not capitalised or holding sufficient liquidity to cope with the credit and liquidity risks involved in putting up margins.

4.18 Question 18: Action by competition authorities in FICC markets?

18.1. We are very sceptical of such action.

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[4] The ACT's position is that it opposes cross-subsidisation of services from banks, as giving potentially misleading signals of the true costs incurred by firms and likely shutting out potential new service providers. Probably though, some or even most treasurers quite like it. This is not just habit and complacency: it may ensure that the bank will provide services they might not otherwise provide; banks tend to underestimate the likely volume of and what they lose on the subsidised products and overestimate the volume of and likely gains on the over-priced products; banks may lurch from marginal cost pricing to trying to apply full cost recovery pricing, so a little muddying of the waters may be seen as helpful to the customer; a little mystery can help the treasurer in relations with operating units in his own firm. See also 18.1.1, below.

[5] http://www.fdic.gov/regulations/laws/rules/6000-100.html, Bank Holding Company Act of 1956, see 106(b)(1) etc. as amended (1970) - http://www.fdic.gov/regulations/laws/rules/6000-1000.html#fdic6000sec.106b.

[6] Commonly a corporate will mark a much smaller credit limit for the bank than the bank will mark for the corporate – due to the corporates likely concentrated credit risk portfolio its smaller balance sheet and because taking on credit exposures is not its underlying business so it lacks systems and expertise in the area.

18.1.1. The “bundling” of products by banks referred to in 17.1.3. above leads to great un-clarity of pricing[4]. We discuss this at length in the Appendix to our submission (http://www.treasurers.org/hmt/nbl/actresponse) to HM Treasury’s consultation paper on Non-bank Lending in 2010. We have regularly discussed this with the changing UK competition authorities but action does not seem possible.

4.19 Question 19: Promoting competition and discipline by regulatory reform?

19. No comment

4.20 Question 13: Need for awareness of competition framework?

20.1. Education about the framework of competition regulation and requirements is fundamental for observance. However it seems unlikely that persons colluding among firms to influence prices could not have known – or at least suspected – that that was likely outwith what was permitted. So it is a necessary but not sufficient condition.

4.21 Question 21: Benchmarks: are further measures needed?

21.1. We think that measure in hand are likely to be sufficient as they are worked through and applied appropriately to different benchmarks. Indeed some of the detailed provisions of the IOSCO/FSB recommendations seem excessive and damaging – in making a benchmark more costly to compile or reducing its utility by required definitional changes. Accordingly, national competent authorities need to exercise careful discretion in application of those recommendations.

21.2. For example, we recently canvassed a lot of non-financial corporate opinions on the changes discussed in ICE Benchmarks’ paper on evolution of LIBOR (towards meeting the IOSCO recommendations). We found that firms saw little advantage or even disadvantage in many of the proposals. The only advantages to the changes were if contributing banks or additional potential contributing banks felt themselves unable to ensure good-faith submission of inputs to the administrator, vulnerable to reputational risk and financial and other penalties and accordingly unwilling to continue without the types of change proposed.

21.3. There is, however, one step that authorities need to take from time to time.

Authorities are able to weaken confidence in benchmarks previously controversial by silence as well as by expressions of concern. We may have missed one, but the last (relatively) positive statement about LIBOR we noted was from Lord Turner, past Chairman of the FSA, who said in 2012: (Reuters, http://tiny.cc/eb6zhw, and evidence to the Treasury Select Committee) that "[Libor] has been pretty robust since 2009 and 2010". "People are trying to do it as honestly as they can." The regulator has advised banks on process for arriving at rates. Banks have had formally to attest to the quality of their Libor submission process to the regulator. "I would be very amazed if at the moment there is anything remotely like the problems of the past in terms of deliberate manipulation."

Since then, great strides in monitoring bank submissions and other improvements have been made by ICE Benchmarks Administration, the new LIBOR administrator that has also published its thoughts on evolution of LIBOR, setting out further changes. A few positive words would be welcome.

4.22 Question 22: Benchmarks: Reducing reliance on benchmarks?

22.1. The most important step in reducing reliance by market participants on benchmarks is reducing use through specification in regulation – though in some cases such specification will need to remain on practical grounds.

22.2. Otherwise, if firms – financial or non-financial – find a benchmark useful and it can be provided at an acceptable cost, why should it not be used provided there is a level of safeguards against (market) manipulation in its compilation? Benchmarks provide an understandable common language between contracting parties and in arriving at valuations etc. for valuation and reporting purposes. Without publicly available benchmarks, the advantages of large firms with large amounts of internal data are emphasised.

4.23 Question 23: Benchmarks: Changing benchmarks?

23.1. We do not think that further, additional, prescription of changes across the board, is likely to be helpful.

23.1.1. Rather it is important to allow users to get accustomed to the new regulatory framework and develop confidence. And that will enable them better to understand any consequent consultations, perhaps arising from applied common sense or from the new regulatory framework, on changes in the benchmarks' definitions, calculations or methodologies and the implications of those changes.

23.2. Importantly, however, users of the benchmarks should be encouraged (but not directed or required) to consider if any particular benchmark is the most suitable for their purpose.

23.3. For example, it can be a mystery why lenders and borrowers in the domestic US housing mortgage market use a euro-dollar interest rate (LIBOR).

23.3.1. But they probably have a good reason.

Historically that reason has often been "because it was available". And, reasonably, people attribute value to ease of availability, and do not mind some, sometimes many, theoretical imperfections provided the rate is usefully accurate and reliably available.

The "availability" reason is indeed a common reason, as well as a good one. For example, many corporate treasurers would never dream of dealing at the WM Reuters foreign exchange fix – and indeed avoid dealing around that time because of rate movements at that time – and dealing involves cash flows. But they will happily use that fix in valuations for accounting purposes because it has been accepted without question by auditors and is easily available, and accounts are not cash flows.

23.4. If benchmark administration is not over-burdened with regulation, maybe new benchmarks that people may find (more) pertinent to their uses, will be conceived. But users will need confidence that benchmarks will be published reliably, for longer than their expected use. Establishing that confidence will be very difficult.

4.24 Question 24: A panel on benchmark use and design?

24.1. We have had inputs on this from IOSCO, the FSB, national authorities, and, we are expecting, the European Union. There have been many reports on the subject.

Maybe an "industry panel" can help, if it is carefully composed and with the right brief. That's not easy.

24.2. Of course "industry panel" in this section on benchmarks raises the question of "Which industry?"

24.2.1. It may mean the "industry" of making FICC markets, or of trading or "investing" financially in them.

24.2.2. Should it include people working in the market whose activity generates the information on which the benchmark would be based? They may be widely scattered around the financial services or oil or energy, primary products production, etc. industries relevant.

24.2.3. And what about likely users – which would involve people from whole new ranges of activity, both financial and real economy?

24.2.4. And might academics be useful? Some, maybe. But their record of application of favourite models they developed some time ago for use in another context – or put together on an airline napkin on their way over from New England does not fill one with confidence.

24.2.5. "Industry" may, more obviously, alternatively have been meant to refer to the "industry" of publishing benchmarks.

As many benchmark publishers are doing it almost accidentally, incidentally to some other activity, one may doubt how viable such an "industry panel" may be. But experience in other new "industries" – high tech, biotech – emphasises the importance of informal meeting and discussion opportunities, and maybe this is what was in mind.

24.3. And those that take part in a general "industry" panel considering many benchmarks, if that is what is envisaged, will need to understand that what they know about one benchmark may not be portable to another benchmark – even if what they "know" is indeed correct.

4.25 Question 25: Measures to ensure full compliance with IOSCO benchmark principles?

25.1. Please see the discussion in response to Question 21, above. We make the point that national competent authorities need to exercise careful discretion in

application of some IOSCO recommendations. “Full” compliance may not be helpful.

4.26 Question 26: Protection over benchmarks administered in other jurisdictions?

26.1. There should be distinction between any retail financial use (or use connected to retail activity) of benchmarks on the one hand and use by (larger) commercial and industrial firms.

26.1.1. Non-SME, non-financial firms wanting to use FICC contracts that are not available in particular jurisdictions, should not be constrained from using benchmarks available from other jurisdictions if, commercially, they believe it advantageous to use them. Such contracts may cover, for example, commodities they use (or that compete with those they use). Globally operating firms would be able to do that anyway through units in other jurisdictions, but that may be inconvenient, expensive, involve wide application of systems than is secure or increase other operational risk.

26.1.2. As regards SMEs (often dealt with as retail customers) using such contracts, it would seem harsh simply to prevent their using benchmarks from other jurisdictions as potentially commercially disadvantaging them. The consultation questions relating to the relationship between regulated firms and customers are relevant.

4.27 Question 27: Is information on existing standards of practice sufficiently clear?

27.1. The large number of codes can be confusing for FICC market users – who need to understand what standards will apply in a market.

Whereas a large financial institution will have dealing staff specialising in particular markets, many, even quite large, non-financials will use generalists dealing across a number of markets, the volume in any one of them not justifying use of specialists. That is even more true of the dealers’ supervisors and managers.

27.2. Standardisation of aspects of the codes can make assimilation easier for users – and indeed for those providing and overseeing the FICC markets.

27.2.1. In many cases the principles being followed by the various codes are very similar but they may be set out in different terms inherited from the past or the result of different compromises in wording. A standardisation of principles would be a simplification. The FCA’s principles provide a basis. The temptation to add additional principles applicable to a particular market should be resisted.

27.3. We note the tension between detailed rules and more general guidance in applying the principles in particular markets.

27.3.1. The ACT was represented on the FSA’s Market Abuse Practitioners Panel. Very frequently those present from banks were pressing for bright-line rules – to make training of dealers easier. Those from market users were concerned about the unsubtlety of rules and the opportunity for gaming or avoidance they threw up.

The banks did not like that violation of the FSA's principles may be sanctioned. The users liked it, however.

The solution is always in some sort of compromise and the outcomes will vary over time in reaction to events.

27.3.2. As more dealing becomes automated, more "rules" may be needed. But the same principles – re last look, front running, etc. must be preserved. And a lot of the rules will relate to information to be given to users when they sign up to use the systems or changes made from time to time. It should not be an excuse for more "dumbing down".

4.28 Question 28: Uncertainties in applying existing market standards?

28.1. We would only comment that we do not believe that there was any uncertainty on standards involved in the LIBOR or FX scandals. Conspiring to manipulate could not conceivably have been within any "standard".

4.29 Question 29: Reducing uncertainties?

29.1. The mischief seems to have been in persons understanding that the standards applied to them. Education, supervision and governance are key. The conclusions of the Lambert Banking Standards Review are relevant.

4.30 Question 30: Improving understanding of codes and regulations?

30.1. See Question 29, above.

4.31 Question 31: Professional qualifications for those in FICC markets?

31.1. See Question 29, above.

31.2. There are two aspects here: knowledge/education (qualifications) on the one hand and ethics on the other.

31.2.1. Qualifications relate to understanding of the market, rules, regulations, etc. Basic qualification here is very important. "Picking it up on the job" means incomplete and non-generalisable learning. That presents a large risk when dealers are promoted into supervisory and managerial positons or move firms (though it is often seen by employers as helping tie staff to the firm).

31.2.2. Some have been tempted to argue that there is no place for privately sponsored ethical codes in an age of pervasive regulation. But regulation and rues are, in the nature of things, likely to be incomplete. That is not to say that ethics exists or must be prioritised, only in the cracks, of course[7].

Adherence to some sort of ethical code is expected in the membership conditions of UK and Commonwealth chartered and would-be chartered professional bodies. These go beyond mere following of regulation. Expulsion after

[7] There is some discussion of the section "Does ethics matter" in the ACT's hand-out, *Ethics in an Era of Regulation*, http://www.treasurers.org/system/files/ethics_era_of_regulation.pdf.

complaint/disciplinary proceedings by such a professional body should not be "hushed-up" and we would recommend that regulated firms should be both entitled to and required to ask potential recruits to notify them if they have been or become in that position.

It is, however desirable, probably not practical to require all dealer-level staff in FICC to belong to such professional bodies. But it could be looked for at more senior levels. (The new body introduced following the Lambert Review is, at least initially, for firms rather than individuals.)

4.32 Question 32: Role of codes re standards?

32.1. Codes scan serve educational and reference purposes. Good codes in one jurisdiction can be exemplary for other jurisdictions. Better are internationally agreed codes that we discuss in the next sub-section.

32.2.1. Internationally agreed codes are unlikely to be comprehensive or seen, at least in in some jurisdictions, as sufficient. Interpretation of codes and of supervening ethical requirements is likely to vary from jurisdiction to jurisdiction as well as evolving over time.

So, we would see the role of international codes as setting a minimum standard rather than being entirely self-sufficient. Such a code should, thus, not seen as itself "enforceable".

It would, then, be important for particular jurisdictions not to abdicate the matter to international codes but rather to incorporate the international codes into adapted, expanded, clarified, or whatever, codes sponsored in the jurisdiction and with effect subject to local interpretations and case precedents – though not being bound by precedent in order to allow for judgement and response to innovation. (See also comments in response to the next Question.)

4.33 Question 33: Code design – and teeth?

33.1. If a code is to be internationally accepted, it is likely to be slow and perhaps difficult to change. Agreed interpretations and precedents are likely to be even more delayed. The approach we discuss in the comment on the previous question is pertinent.

33.2. On the matter of "teeth" for a code, there is an interesting precedent of a code given teeth.

33.2.1. When the Financial Services Act was first drafted in the UK, uncertainty about the regulatory boundaries. Some large firms of solicitors took the view that parent companies or subsidiaries in non-financial groups that undertook financing or financial transactions (risk transfer products, derivatives, etc.) within the group or in relation to its business may require to be authorised.

To avoid this unintended consequence, a new "permitted" status was incorporated into the Act. One condition being granted or retaining permitted status was, where relevant, observance of the NIPs Code published by the Bank of England. So the

NIPs Code – of recommended best practice – had become effectively mandatory for the affected non-financial firms[8].

33.3.1. One thing that is missing from many codes is a body representative of the market including users that can provide "rulings" or interpretations on request – as the Consultation notes. The Consultation gives an example of the advantages of the published rulings by the Panel under the Takeover Code.

33.3.2. We would draw attention to another precedent. That is in relation to pre-emption – the requirement for an issue of new shares in a company having to be offered first to existing shareholders pro-rate to their existing holdings[9].

33.3.3. The Pre-emption Guidelines in the UK were issued and are overseen by the Pre-Emption Group (including issuers, investors and intermediaries, etc.). The Pre-emption Group is able to revise the Guidelines from time to time, monitor their operation and opine on disputes or requirements for interpretation. After a number of years, with useful precedents established, the subject became less controversial. Advising lawyers and bankers have advised firms to avoid the reputational risk there would be by ignoring the Guidelines. Accordingly the Pre-Emption Group has twice stopped meeting to be summoned back into existence when needed.[10]

33.3.4. We believe that the existence of the Pre-emption Group with its opportunity to monitor, review, hear grievances or queries was key in sustaining confidence and order under the operation of the Guidelines as purely advisory instruments. Some kind of such group or panel would be a useful adjunct to any FICC code.

33.4. Regulator comment (articles, speeches, etc.) endorsing codes is important. A code's listing of support from many bodies contributes too. The Bank of England published NIPs Code has since its original publication carried the

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[8] During passage of the Bill two of the most prominent London firms of solicitors expressed concerns over the requirement for authorisation, two of them not seeing it as a problem. After the Act was implemented, the list of permitted persons published by the FSA consisted mostly of clients of the firms not seeing it as a problem, the two firms whose concern caused the insertion of the permitted status into the Act having by then decided there was no issue. The status was deleted in later amendments of the Act.

[9] The Myners report published in 2005, accepted by the Government, confirmed that pre-emption should continue to be a fundamental part of UK company law as a key shareholder protection – especially of minority shareholders (http://webarchive.nationalarchives.gov.uk/20070603164510/http://www.dti.gov.uk/cld/report_pdfs/02).

[10] 1.1.1. In the 1980s, more interest was taken in the UK stock market by US investors. Pre-emption described by US courts in the 1920s as a fundamental part of US law was soon mostly disapplied. So US investors coming to the UK found it hard to accept that buying news shares (and fractional control) at an undervalue (or at all) was subject to some control by existing shareholders. UK law provided that shareholders may give prior approval to a certain fraction of new share issue. But in response to what it saw as abuses, the NAPF said it would against anything more than a much smaller threshold. The ACT and the ABI thought the NAPF's limit was too small.

On the prompting of the ACT and the ABI, the Bank of England promoted wide discussions that led to the publication in 1987 of the "Pre-emption Guidelines" and creation of the Pre-emption Group to review the working of the Guidelines and to opine on issues arising from their operation. The Stock Exchange provided secretarial support and required the completion of information forms on any non-pre-emptive issue but the guidelines were just that, not regulations.

The system worked well. The matter became less controversial and, after the Stock Exchange passed its regulatory responsibilities to the UKLA the Pre-emption Group continued, with secretarial support from the ABI under a Chairman provided by CISI for a few years. The Pre-emption Group was re-established under the auspices of the FCA following the 2004/5 Myners Review[8] and revised the 1987 Guidelines. It lapsed again after a while as the issue again became less controversial. The FRC is currently re-constituting it.

endorsement of a number of organisations (including the ACT which is represented on relevant central bank committees). Much more formally, the endorsement of a code as "industry guidance" by the FCA is, of course, very powerful in getting a supervised market-participant's attention.

4.34 Question 34: Extending the scope of regulation?

34.1. In general we make no comment on this question.

34.2. However, we wish to comment on paragraph 16 of 5.4 of the Consultation and this may be the question to which the comment is relevant.

We are concerned at a, probably unintended, implication, of the text where it says in brackets after referring to the need for international coordination "given the global nature of FX markets, and the fact that many countries' currencies are traded outside their borders". We are puzzled. It would be like the government of a country with a gold mining industry being concerned that gold is traded outside their country. It may be that we have misunderstood the implication of the phrasing, of course.

We think that a jurisdiction's authorities may be concerned about trading that goes on inside their jurisdiction – regardless of what is traded. But their legitimate way of influencing trading outside their own jurisdiction is to trade in that other jurisdiction if it is an issue of price or liquidity, or otherwise to make speeches and write articles and use soft power of influence. Of course foreign authorities would, it is to be hoped, cooperate in cases of outright fraud and deception. But, in general, while it may be nice if other markets had the home-market's no doubt high standards of conduct etc., that is not the business of the home-market authorities, surely.

4.35 Question 35: More instruments within scope?

35. No comment

4.36 Question 36: Inadequate governance etc. Role in FICC abuses?

36. We believe that inadequate governance, accountability and incentive arrangements played a large part in the abuses – together with large organisations being "run" by persons with no idea of how to secure uniform standards of behaviour throughout a large body. This has been well trawled over elsewhere and we make no comment here.

4.37 Question 37: Market wide conduct, incentives, governance?

37. No comment

4.38 Question 38: BSRC role?

38. We have strongly supported the Lambert review and its recommendations, but make no further comment here.

4.39 Question 39: Regulatory measures to improve governance and incentives?

39. No comment

4.40 Questions 40-49: Surveillance and penalties?

40. No comment

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