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Response to the Fair and Effective Markets Review

Q1. The Review would welcome respondents' views on the definition of 'fair and effective' FICC markets proposed in Section 3. Does it strike the right balance between safeguarding the interests of end-users without unnecessarily impeding the effectiveness of FICC markets? Are the concepts of transparency, openness and equality of opportunity appropriately specified? And how does the definition compare with those used in other markets, jurisdictions, organisations or legislation?

Response n/a.

Q2. Of the six themes identified in Table A on page 5 (market microstructure; competition and market discipline; benchmarks; standards of market practice; responsibilities and incentives; and surveillance and penalties), which do you consider to be the most important factors contributing to the recent series of FICC market abuses? In which other areas do you believe the fairness and effectiveness of FICC markets globally may be deficient? Do these answers vary across jurisdictions, or specific markets within FICC? Are there any other important areas of vulnerability that are not identified in the table?

By means of example, the recent FX failings have been attributed to poor culture, lack of clarity around accepted and non-accepted practices, and weak internal controls, governance and supervision mechanisms. There are three areas where the regulatory framework of the spot FX market would benefit from more structure, which could be set out in codes, to help close these gaps:

- Clear definitions of acceptable and unacceptable practices;
- Clearly articulated senior management responsibilities and accountability, controls and governance arrangements; and
- Formal mechanisms for reporting suspicions to an appropriate authority.

Q3. Do trading practices involving <u>barrier or digital</u> options pose risks to the fairness and effectiveness of one or more FICC markets? How hard is it to distinguish between <u>hedging and 'defending'</u> such options in practice? Should further measures be taken to deal with the risks posed by barrier options, whether through market-wide disclosure of significant barrier positions, an extension of regulation or some other route?

We believe that barrier options generally enhance market effectiveness by providing a cheaper alternative to vanilla options for participants looking to hedge risk positions. In order to ensure that barrier options remain economic for providers to write, it is important that they can be effectively risk-managed. If any constraints were applied to the risk management process, the cost of providing the option to clients would increase, and would need to be passed onto the end-user. This would diminish the option's effectiveness as a hedging instrument.

There is no clear delineation between risk management of a barrier option position, and the practice of 'defending' the option. Path dependent options have payoffs which depend on when and if options reach a pre-determined price. Risk management of these products necessitates the ability to de-hedge upon those events and in certain cases those de-hedge orders may be large and impact the underlying market. This is because the delta of a barrier option will tend to be higher than a traditional European option, necessitating a larger hedge and therefore carrying a larger risk of market impact when the hedge is unwound. If a market participant were seeking to defend an option, they would need to place trades in the underlying market in order to affect the value of the option by influencing the reference price. In practice, this activity looks similar to unwinding a hedge, and it can be very difficult to distinguish between the two activities, even though they both serve very different functions. To mitigate this we recommend greater enforcement of suitability checks in the sales process, greater use of disclosures and an industry led market-wide code of conduct to provide guidance on acceptable risk management practices (we understand that many of the banks have existing risk management practices governing the use of these products and we believe that work is required to ensure that they are consistent). In particular client disclosures should include informing the client of the dealer/client relationship (i.e. agency or principal) and highlighting the requirement for the principal dealer to risk manage their position and the potential implications.

Q4. Does the market microstructure of specific FICC markets — including trading structures, transparency, asset heterogeneity or market access — enhance or diminish fairness and effectiveness? Where there are deficiencies, will recent or in-train regulatory or technological changes improve the situation, or are further steps needed? How do these answers vary across jurisdictions, or specific markets within FICC?

We have provided an answer to this question with regard to FX only, and not all FICC markets. The FX market (which includes spot, forwards, swaps, options and NDFs), has evolved over time in response to end user requirements, and is one of the largest and most liquid markets in the world. However, there are elements of the market which have been identified as potentially diminishing fairness and effectiveness.

1. *Strengths of the FX markets*

In our view, the FX market has a number of strengths. One of these is liquidity; the FX market is one of the largest and most liquid markets, and mainly operates as a principal based model. The market does not suffer from the liquidity challenges faced by some other FICC markets, owing in part to the structure of the product (more homogenous, shorter tenors) and in part to the structure of the market. Under the principal model dealers provide committed prices to clients, absorb a number of trading costs on behalf of clients (e.g. brokerage, settlement), and actively support liquidity in the market through times of stress. A range of non-bank financial institutions make markets on some all-to-all platforms, as well as direct to dealers, providing a further source of liquidity to the market. We also believe that the FX market is highly accessible to interested participants. The diversity of venues allows clients to select between multiple channels to access the market, including independent multi-dealer platforms, bank-owned platforms, specialist distributors and traditional voice-based interactions. This has been enhanced by the growth of electronic trading, which allows clients many ways to compare prices more

conveniently and more rapidly than previously possible. Different channels to access the market offer differing trade-offs across speed, confidentiality, advice, cost and convenience and to a large degree end-users are able to select the channel that best suits their needs.

Further, the FX markets are highly transparent. Spot FX has been at the forefront of electronic-trading advances, leading to a high level of transparency. The growth of multi-dealer platforms (MDPs) and software solutions to obtain prices from multiple sources (e.g. aggregators) has further aided transparency. Outside of spot FX, the introduction of the Dodd-Frank Swap Execution Facility (SEF) and the Organised Trading Facility (OTF) regime in MiFID 2, together with the wider roll out of multilateral trading facilities (MTFs) to non-equity where applicable are designed to increase the "many-to-many" trading venues and mandate trading on such venues. See Q8 for more details.

Enhancements to post-trade reporting are also underway. In Europe, these requirements are defined by EMIR (and MiFIR) for forwards, swaps, options and NDFs, and in the US by Dodd-Frank for options and NDFs. There is an opportunity to consider whether there are material benefits to subjecting spot FX to similar post-trade price transparency requirements, and whether such benefits would outweigh costs in doing so.

There are also a number of safeguards built into the FX markets to ensure that end-users are able to receive tighter spreads from their dealers. One of these safeguards is last look. Last look is an important tool for dealers to effectively manage latency and counterparty credit risk in return for tighter spreads for the end-user. Without last look, clients and end-users would need to incur significant expense by building their own trading infrastructure in order to mitigate these risks themselves – something they rarely have the resource or competency to do.

2. *Potential weaknesses of the FX markets*

There are some elements to the FX markets that could be perceived to diminish fairness or effectiveness. One of these points is a lack of clarity of the role of the dealer. The basis on which market participants are interacting with a dealer may not always be clear. This is linked to the concerns raised over internalisation, which is an inherent feature of a principal-based market.

Addressing the concern of internalisation raised above, we believe that internalisation can have the effect of enhancing liquidity and improving prices, resulting in lower costs for many market participants. However, we believe that greater disclosure over how and when internalisation will be used by a dealer is required to ensure that end users can be confident that they are getting the best deal.

Another area of concern is around certain execution practices. Certain execution practices (such as stop loss orders, last look, option defending and fix orders) present a risk of unfair treatment of end users. While we do not believe that widespread problems exist, particularly with last look, these risks could be mitigated through greater clarity and detail in rules and statutory based codes of conduct to underpin acceptable execution policies and appropriate enforcement. An example of where greater clarity is required could be between legitimate trading for risk management purposes and inappropriate trading.

Finally concerns have been expressed on the potential for misuse of information. Inappropriate use of trading information, such as a trader within a firm using client order information from others within the firm (e.g., sales or trading) to execute trades before such client orders are executed have the ability to profit from such information. Greater clarity on appropriate / inappropriate use of information by all market participants would be beneficial.

Q5: Is greater use of electronic trading venues for a wider range of market participants possible or desirable? Are there barriers preventing a shift to a more transparent market structure?

A greater use of electronic trading venues is both possible and desirable. Electronic trading venues have a number of advantages:

1. Markets remain fair for all by ensuring that trading occurs in a fair, open and transparent way and according to non-discretionary rules;
2. Trading venues have an obligation to ensure robust infrastructure to ensure their markets continue to operate effectively, even in times of market stress;
3. Trading venues can provide an appropriate level of transparency to the market.

However, trading venues need to be calibrated to the market in question, taking into consideration the nature of liquidity in those markets and the types of participants who are active on them. Not all products are suitable for "exchange like" trading. To be clear, our understanding is that "exchange like" is analogous to a central limit order book (CLOB). The fixed income markets are characterised by a large number of instruments with relatively shallow liquidity profiles; liquidity will tend to be greatest at issue but will then tend to tail off during the life of the bond. These types of instruments will tend to be more suited to Request for Quote (RFQ) "liquidity by appointment" systems or, potentially, quote driven systems. Any requirements that impose "exchange like" trading requirements to fixed income would have the impact of dramatically reducing liquidity in those instruments, resulting in an increase to the cost of capital for the issuer. For that reason, the transparency requirements imposed on trading venues need to be calibrated in a way that ensures that an appropriate level of transparency is available to the market to better inform price discovery while the ability of firms to continue to hedge risk effectively is maintained.

We are aware that MiFID2 will impose certain pre- and post-trade transparency requirements on trading venues. For non-equity, RFQ systems will need to be pre-trade transparent unless the trade is above the Size Specific to the Instrument Threshold (SSTI), in which case indicative prices will need to be made available. Because of the nature of RFQ systems and the type of liquidity within these systems, we believe that this threshold should be set at a low level to ensure that markets remain fair and effective, especially for non-government FI asset classes.

Q6: Is standardisation of corporate bond issuance possible or desirable? Should standardisation be contemplated across a broader range of fixed income products? How could that be brought about?

Response n/a.

Q7: Should the new issue process for bonds be made more transparent through the use of auction mechanisms, publication of allocations or some other route?

Response n/a.

Q8. Are there risks associated with internalisation and last look practices? Are there barriers preventing increased pre and post-trade transparency in foreign exchange markets?

1. *Internalisation*

We recognise that internalisation carries some benefits to market participants and end-users in the form of tighter spreads and better prices. However, the payoff can be reduced transparency in public markets that may adversely affect efficient price discovery. It is important to distinguish between internalisation in a principal based market (such as FX) and internalisation in an agency based market (such as listed equities).

Where a firm operates as principal, they operate as market-makers through liquidity provision, and taking on risk-taking and balance-sheet commitment to their counterparties. Liquidity providers will provide prices to their clients pre-trade and the client may select a counterparty based on that advertised price. Once selected, that firm will commit to executing the trade and will bear the market risk that arises as a result. Once the firm has committed to executing the trade, they may do this in several ways, including internalising the trade against other client orders, or executing the order in the wider market. Firms engaged in principal trading are traditionally compensated in the form of a bid-offer spread. To the extent that earning a bid offer spread from a client's limit order may be in conflict with showing that order to the market, it is important that the dealer discloses the market scenario under which the limit order will be executed from the dealer's inventory. Regarding stop loss orders, clarity of the risk management procedures used by the dealer would also be beneficial.

A firm acts as agent when the client requests that firm to work an order in the market place on the client's behalf. In this case, the client, and not the firm, assumes the consequent market risk. The agent has a duty to their client to execute the order as efficiently as possible, and this may include internalisation, in which case the agent should let this be known to the client and be prepared to demonstrate that this was the most efficient form of execution. Agency business is usually segregated from principal trading activities within a firm, and agency trading is traditionally remunerated in the form of a fee or commission.

It is possible that the increase in internalisation in the FX markets may have come at the expense of transparency in the wider market. It is likely that changes in MiFID 2 may mitigate this, albeit in a limited way. All transactions in FX apart from spot will need to be post-trade reported. In addition, some pre-trade transparency requirements will apply to instruments captured by the trading obligation and therefore required to be traded on a trading venue. Further, Systematic Internalisers will be required to make their quotes public in an instrument for which there is a liquid market and where the trading obligation does not apply.

We believe that the market would benefit from the provision of greater disclosures with regard to internalisation, specifically:

- Active client education on internalisation practices
- Greater disclosure for dark pools, and their equivalent, of matching methodology and details of liquidity providers
- Greater record keeping requirements to ensure that dealers can demonstrate to their clients, on request, that the client did not receive an inferior execution as a result of being internalised. Alternatively, greater disclosure to clients of banks' internal policies as to when and how client orders will be internalised could be made.
- Disclosure to the client on the capacity in which the dealer is trading i.e. either as agent, principal or riskless principal.

We are aware that MiFID 2 will impose new best execution reporting requirements on dealers acting as Systematic Internalisers or who conduct agency business within an OTF. We believe that these new requirements will help ensure that clients can be satisfied that dealers are acting in their best interests.

2. *Last Look*

Last look serves an important function in the FX markets. Last look allows dealers to reject orders within a short time period in order to manage latency and counterparty risk and has evolved over time, particularly with the advent of electronic trading.

While electronic platforms have developed substantially since, both in sophistication and speed, the importance of last look remains. Last look continues to provide dealers with an effective mechanism to manage both latency and counterparty credit risk. This enables dealers to offer better prices to their clients through tighter bid-offer spreads, thereby improving the effectiveness of the market and reducing the cost of transacting for end users; without last look clients would be required to invest significantly in trading infrastructure in order to mitigate latency and credit risk themselves.

We are aware that concerns have been raised about the potential for last look practices to be misused. While we believe that last look provides an important service to the market, we acknowledge the potential for abuse. Specifically there are two potential areas for misuse:

1. Dealers displaying prices without an intention to trade, in order to gain information advantages. This provides the illusion on liquidity which ultimately will prove to be amorphous.
2. Dealers only confirm trades that are ultimately beneficial to the dealer, rejecting other trades.

In order to mitigate the possibility of misuse occurring, we believe that industry led global codes of conduct should be developed that apply to all market participants. Such a code of conduct should outline what disclosures should be made to counterparties, and could include the concept of last look and the associated benefits and risks involved, as well as defining the surveillance and control mechanisms market participants should have in place to ensure that potential abuses are identified. This

disclosure would give clients the ability to choose the liquidity pools that best fit their needs. Without that choice clients would have to incur higher transactions costs due to wider spreads.

We do not believe that further public disclosures, such as publication of trade completion rates and response times, should be mandated. Firstly, this would prove difficult to implement given the highly diverse nature of the FX market and the confidentiality requirements dealers are held to; and secondly, clients should already be aware of their own completion rates.

3. *Pre- and post-trade transparency*

The FX markets operate in a transparent environment, particularly in spot FX. Prices have been effectively centralised through the increased use of aggregators that bring together many different pricing sources and has contributed to an increase in pre-trade transparency.

MiFID2 and Dodd-Frank, together with EMIR, are driving increasing levels of transparency outside of spot FX. The SEF regime in the USA, and the introduction of the organised trading facility (OTF) in Europe and the wider roll out of MTFs in non-equity will lead to greater use of multilateral platforms.

In MiFIR, derivatives subject to the trading obligation will need to be traded on a Regulated Market (RM), an OTF or an MTF. These trading venues will have certain requirements to make orders/quotes pre-trade transparent. In the absence of a trading obligation, Systematic Internalisers (SIs) will have certain quoting requirements depending on the size of the order and whether they are transacting in a liquid market or not. In addition, all execution venues (SIs, RMs, MTFs and OTFs) will be required to make post-trade information available to the public on a reasonable commercial basis.

It is likely that these regulatory changes will further increase transparency in the FX markets. However, FX spot is not captured by these developments because FX spot is neither a swap for Dodd-Frank purposes nor a financial instrument for MiFID purposes. As a result, public post-trade information for spot FX is not available in either the US or the EU.

Imposing a post-trade regime on spot FX could be considered. However, the correct calibration of such a regime would be essential. In particular, any regime would need to consider the nature of the spot market in order to apply the requirements to the wholesale markets without undermining the effectiveness of the transactional market, for which we do not believe a post-trade feed would be appropriate.

Q9. Are there barriers impeding the development of more comprehensive netting and execution facilities for transacting foreign exchange fix orders?

In the FX markets it is common for participants to transact at a benchmark price in order to value their portfolios or to aid execution transparency. Traditionally this benchmark price has been the WM/R fix.
Concerns have been raised that dealers could trade ahead of the fix in order to ensure a profit in executing client orders.

In September 2014 the FSB's Foreign Exchange Benchmark Group (FXBG) issued 15 recommendations to address these perceived issues with the calculation and execution of benchmark fix trades. Within these recommendations, the FXBG supported industry initiatives to develop independent netting and execution facilities for the transaction of fix orders.

Thomson Reuters responded to and generally agreed with the recommendations made by the FSB FXBG. We believe that comprehensive central netting facilities would ensure that the netting process was fully effective and subject to independent rules in order to maintain the integrity of the process. However, we acknowledge the potential for increased costs this may bring, both in setting up these facilities and in possible increased running costs, which we consider to be the main barrier to uptake of these new services by the end users.

With regard to execution facilities, we believe that the market should be free to choose between options to ensure that the replication process can evolve in a way that it effectively meets the market's needs. Options could include but not be limited to clients paying a fixed fee to a principal to run the replication process for them. Alternatively clients could rent the use of existing infrastructure and assume the basis between the benchmark and the replication cost. Finally clients/participants could build their own infrastructure and algorithms and assume the cost for this.

Q10. Are there any material barriers preventing greater transparency in OTC commodity derivatives markets? If so, what could be done to remove them?

Liquidity in the OTC commodity derivatives markets is typically fragmented across multiple trading venues and not always complete in terms of bid/offer/trade prices and associated volumes. Although many of the venues operate trading platforms based on a common technology, the cost to trading firms of constructing an aggregation of full market transparency is relatively high when compared to gaining a similar view of exchange-traded derivatives. In addition, the historical constraints and/or commercial terms levied on the distribution of real-time information originating on those trading platforms over mainstream market data vendor services has made it less than optimal for traders to analyse, correlate and compare trends for OTC commodity derivatives prices in the context of a broader set of financial indicators on the distribution platform of their choice. A potential solution is for all trading firms to gain access to a consolidated feed of OTC commodity derivatives market activity from all trading venues at reasonable commercial terms via the market data vendor of their choice, even though they may not be able to trade on all prices as a consequence of not being members of all trading venues.

Q11. Are there any areas of FICC markets where regulatory measures or internationally co-ordinated regulatory action are necessary to address fundamental structural problems that exist?

Response n/a.

Q12. Where do potential conflicts of interest arise in the various FICC markets, and how do they affect the use and potential abuse of confidential information, both within and between firms?

Response n/a.

Q13. How can the vulnerabilities posed by such conflicts be reduced? Are existing internal structures and control procedures sufficient? Where they are not, are further internal management controls required (such as better trading floor design and/or closer monitoring of electronic communications within and between firms) or is more radical action required to remove conflicts altogether?

Response n/a.

Q14. Is there a relationship between the level of competition in FICC markets globally and the fairness and effectiveness of those markets? What risks are posed by the increase in concentration seen in some FICC markets? In answering this, please have regard to the geographical scope of any relevant markets.

We do not believe that the FICC markets are unduly concentrated. The FICC markets, and in particular the FX markets, are served by a diverse range of different platforms and participants, including single-dealer platforms, multi-dealer platforms, Electronic Communications Networks (ECNs); this means that competition is rarely an issue.

Q15. To the extent that competition is currently ineffective in any of the FICC markets, are there market-led initiatives, technological or structural changes that may remedy this situation?

Response n/a.

Q16. Are there any lessons that can be drawn from experiences in other financial markets (or indeed other markets) about the ways that alternative or evolving market structures could impact on competition in FICC markets?

Response n/a.

Q17. How effective is market discipline in enforcing sound market practices in each of the key FICC markets? What could be done to strengthen it?

Please see our responses to questions 27, and 29-35.

Q18. In what ways might competition in any of the key FICC markets usefully be addressed by competition authorities (eg by assessing the state of competition in relevant markets)?
Response n/a.

Q19. Are there any additional regulatory reforms that could be helpful in promoting competition and market discipline in FICC markets?

Please see our response to question 39.

Q20. Is there a need for better awareness and understanding of the existing competition framework among FICC market participants, both at firm and individual level? How do you think that might be best achieved?

Response n/a.

Q21. Do current domestic and international initiatives by industry and regulators to improve the robustness of benchmarks go far enough, or are further measures required?

The existing initiatives go a long way to address the needs of the market to ensure objective and accurate benchmarks. Thomson Reuters appreciates the efforts undertaken so far by various entities globally and believe that the quality of major benchmarks has substantially improved. Due to the scope of different benchmarks, markets, asset classes and use of benchmarks, Thomson Reuters advocates to continue to address governance and oversight of benchmarks with principle-based approaches which allow for proportionate implementations that accommodate the wide range of benchmarks and underlying markets which they track. We caution against overly prescriptive measures which do not take into account the wide variations in benchmarks and markets. Thomson Reuters believes that there is room to clarify or extend initiatives by addressing directly the potential conflicts arising from the composition of indices and the regular securities selection that forms part of index administration. Financial Indices, as opposed to financial fixings, consist of a basket of securities that are selected and re-weighted on a regular (monthly, quarterly, semi-annual, or annual basis). The potential conflicts of interest arising from defining the composition of the index, in our view, have not been explicitly addressed in the IOSCO Principles or the ESMA Guidelines.

By selecting the securities that are represented in an index, the Administrator exercises strong influence on the liquidity, price and desirability of these securities. As such, the Administrator can affect the cost of capital for the issuer. Besides the direct impact on cost of capital, the issuer may experience a reputational impact of being included (or excluded) in a benchmark. The ability of the Administrator to influence the composition of the index can exist during the initial design of the methodology that governs the securities selection, during the interpretation of the methodology on rebalancing dates, or by effecting changes to the methodology. This ability to change the composition of an index may give rise to conflicts of interest, such as the issuance and trading of financial products based on an index by the index provider. We therefore believe that guidelines on how to manage these conflicts, or requiring certain independence of index providers from issuing entities (such as banks) and asset managers should be explicitly addressed in benchmark principles, codes of best practices or regulation.

While one can interpret various guidelines and principles, e.g. IOSCO Principle 6 (Benchmark Design); Principle 9 (Transparency of Benchmark determination); Principle 11 (Content of the Methodology); and Principle 12 (Changes to the Methodology), as covering the selection of the securities, we believe that constituent selection and weighting (i.e., “rebalancing”) should be addressed more specifically.

Q22. What steps could be taken to reduce the reliance of asset managers and other investors on benchmarks?

We do not believe that reliance on benchmarks should be reduced, as they provide a critical role as measure of performance and the best way to assess the ability of an asset manager to achieve adequate returns in a given market. An investor needs to be able to compare the returns of her portfolio against the returns of an objective benchmark. In this regard, we believe that the ability of index administrators to offer a wide range of benchmarks, and respond flexibly to client needs, must be maintained. Users of benchmarks should be encouraged to consciously assess their benchmark to ensure they are fit for purpose. We would imagine that there is scope to request that users assess the benchmark for their need and perform an assessment of the benchmark and its application to the user's needs, as different benchmarks are suited for different purposes, even if they cover the same asset class or market.

Q23. What additional changes could be made to the design, construction and governance of benchmarks?

We agree with all of the suggestions put forward in the consultation regarding quality, transparency and robustness of benchmark methodology. We have direct experience of how this can be managed successfully, for example in creating trade based benchmarks for the Singapore market, and moving the LBMA Silver Price benchmark from a poll of submitters to an automated electronic auction, based on actual trades. However, we also welcome the recognition that it may not be feasible to use tradeable input prices for every benchmark.

One of the critical changes that should be made to the design, construction and governance of benchmarks is that all stakeholders – users, operators of benchmarks and the official sector worldwide – should coalesce around one universally agreed set of standards for benchmarks. Currently there are competitive regimes and it is difficult for operators of benchmarks and users to understand what are the correct standards to adopt.

Q24. Should there be an industry panel to discuss benchmark use and design with the aim of assisting industry transition?

Thomson Reuters in general supports market driven solutions to issues and believes that individual consultations are more effective, independent and insightful. As a major global administrator, calculator and publisher of benchmarks, we believe we would be well placed to provide input into this and we would be pleased to participate.

Q25. What further measures are necessary to ensure full compliance with the IOSCO Principles for financial benchmarks by all benchmark providers?

We observe that many benchmark providers, including Thomson Reuters, have made statements regarding their compliance with the IOSCO Principles for Financial Benchmarks. We believe the plans already in place for IOSCO to review compliance on an on-going basis, plus the many streams of regulatory work already underway should ensure full compliance with the IOSCO Principles for Financial Benchmarks.

Q26. How can the regulatory framework provide protection to market participants for benchmarks administered in other jurisdictions in a proportionate way?

The regulatory framework ideally provides protection to market participants for benchmarks administered in other jurisdiction if regulators globally coalesce around a single set of principles - such as the IOSCO Principles and work closely to ensure that local implementation of the Principles are enacted in a maximally harmonious manner, with regulators keeping to an absolute minimum any adaptation of the principles, particularly with regard to gold plating.

Q27. Are existing sources of information regarding standards of market practice across FICC markets globally:

a) already sufficiently clear (or will be once current regulatory reform has concluded);
b) sufficient, but in need of clearer communication or education efforts; or
c) not sufficiently clear, requiring more specific guidance or rules to provide more detail or close genuine gaps?

Our response to this question is limited to spot FX markets. We concur with the statement on page 35 paragraph 4 of the FEMR review paper that the perceived uncertainties in respect of FICC markets are mostly dealt with by existing or incoming regulations and market-wide standards. However, we believe that existing sources of information regarding standards of market practice in respect of spot FX markets are not sufficiently clear, as the present system encompasses a variety of codes globally and in the UK relies on the application high-level principles applicable to regulated firms only for effective enforcement. This said, users of the spot FX markets are both regulated firms and unregulated end-users. Therefore, more specific guidance or code provisions to address the current gaps relating to accepted behaviour, unacceptable practices, and senior management responsibility and accountabilities, controls and governance arrangements that would encourage cultural change, rather than additional regulations, are required. In the case of spot FX, in order to maintain competitiveness, we recommend that, in order to be workable, any code adopted has an international reach, such as the ACI Model Code implemented by the Financial Markets Association. Our answer to this question is therefore (c).

Q28. Box 7 on pages 36–37 discusses a number of uncertainties over FICC market practices reported by market participants, including: the need for greater clarity over when a firm is acting in a principal or an agency capacity; reported difficulties distinguishing between legitimate trading activity and inappropriate front-running or market manipulation; and standards for internal and external communication of market activity. To the extent that there are uncertainties among participants in the different FICC markets over how they should apply existing market standards in less clear-cut situations, what are they?

Response n/a.

Q29. How could any perceived need to reduce uncertainties best be addressed: (a) better education about existing standards; (b) new or more detailed market codes on practices or appropriate controls; or (c) new or more detailed regulatory requirements?

Please see our response to question 27. Additional clarity in particular in relation to accepted and unacceptable market practices set out in a code would be particularly beneficial to market operators and trading participants. We also however believe that, in respect of the gap in relation to spot FX mentioned in question 27, trading venues operating spot FX markets should be responsible for setting and enforcing their own market-abuse type rules (accepted and unacceptable practices). Our answer is therefore (b).

Q.30. How can the industry, firms and regulators improve the understanding of existing codes and regulations by FICC market participants and their managers?

Senior management and board members need to have the skills to understand the nature and complexity of the business they operate in great detail. They must also have line of sight to the risks being taken in order to challenge them. Understanding of existing codes and regulations can be improved by internal training within firms supported by an attestation of understanding signed by the attendee. In addition, to assist further with reinforcing these messages, regulators and trade associations could hold training events and conferences clarifying what the requirements of the codes are.

Q31. Should there be professional qualifications for individuals operating in FICC markets? Are there lessons to learn from other jurisdictions — for example, the Financial Industry Regulatory Authority's General Securities Representative (or 'Series 7') exam?

Regulated trading venues currently have a requirement to ensure that participants are and remain fit and proper and that member firms have adequate systems and controls; this includes taking account of competence and expertise in the relevant product. Trading venues, including those operating in spot FX markets, should therefore maintain this responsibility by setting appropriate requirements for individuals operating in those markets, and by ensuring that their rules are communicated and understood. Additionally, a certification regime, such as those operated by the Financial Markets Association (ACI) for example, to support a strengthening of codes could be considered.

Q32. What role can market codes of practice play in establishing, or reinforcing existing, standards of acceptable market conduct across international FICC markets?

Please see our responses to Q29 and Q30 above. The present system already has codes and principles that participants have been subject to, and these have not prevented abusive conduct taking place in the FX market, although the recent FCA enforcement cases have shown that effective sanctions nevertheless exist, which going forwards, ought to act as a deterrent. This said, the recently reported fines, for example, those announced in November 2014 were for settlement of breaches of FCA Principle 3 (Management and Control) rather than a specific breach of a prohibited practice and were levied against the firms rather than the individuals responsible. A system that held individuals accountable for their behaviour would strengthen the establishment and adoption of acceptable standards of market

conduct. Finally, participants' own internal audit functions, in providing reasonable assurance to governing bodies that appropriate systems and controls to deter, prevent and detect misconduct, also have a role to play in establishing an reinforcing acceptable standards of market conduct.

Q.33 How would any code tackle the design issues discussed in Section 5.4.3, i.e.: how to ensure it can be made sustainable given industry innovation over time? How to differentiate it from existing codes? How to give it teeth (in particular through endorsement by regulatory authorities or an international standard setting body)? How to communicate it to trading teams? Whether, and how, to customise it for individual asset classes?

We believe that voluntary codes are an effective approach. However, to ensure that they are applied properly, a fundamental cultural change is required to ensure that good behaviour is embedded from the ground up within an organisation. In the short-term, this could be achieved through better education of the codes, and clear guidance on what good behaviour looks like. The regulators have a key part to play in communicating what "good" looks like.

Q34. In the context of implementing MiFID 2, which of the FCA Principles for Businesses should apply in relation to MiFID business with Eligible Counterparties?

All the FCA Principles for Business in relation to MiFID business should apply to business with Eligible Counterparties; participants should exhibit the correct behaviour irrespective of the classification of its customer, client or counterparty.

Q35. Are there any financial instruments that should be brought more fully into the scope of regulation in order to improve the fairness and effectiveness of specific FICC markets? For any instruments proposed: (a) what protections does the current framework provide; (b) what gaps remain of relevance to fairness and effectiveness; and (c) what is the cost/benefit case, bearing in mind the Review's Terms of Reference as set out in Section 1?

We believe that the recent investigations into FX markets have demonstrated that for regulated firms these markets are already within the scope of regulation in the UK insofar as market conduct is concerned through the application of high level principles and standards. However, gaps remain in respect of clarity, consistency and certainty around what type of activity is considered abusive in spot FX markets, and how it is described and communicated to market participants. In addition, there are gaps under the present regulatory system in holding individuals accountable for their actions in the FX markets for non-regulated firms. The incoming EU CSMAD/MAR mostly captures market conduct in FICC markets, including in relation to derivatives and financial indices or measures relating to currencies; however, greater guidance on the definition and scope of market abuse regimes in relation to spot FX, where the activities are not related to derivatives or benchmarks, and how individual accountability regimes might be established would be beneficial.

Q36. How much of a role did inadequate governance, accountability and incentive arrangements play in the recent FICC market abuses, and to what extent do these remain potential vulnerabilities in FICC markets globally? In addition to on-going regulatory changes, what further steps can firms take to embed good conduct standards in their internal processes and governance frameworks? And how can the authorities, either internationally or domestically, help to reinforce that process, whether through articulating or incentivising good practice, or through further regulatory steps?

Inadequate governance, accountability and incentive arrangements played a significant role in the recent FICC market abuses. We support better communication by regulators on the interpretation of voluntary industry codes of conduct, improved education of market participants, and a cultural change where everyone shares responsibility for the adherence to the codes of conduct and contributes to fairer markets.

Q37. Do respondents' agree that the thematic areas highlighted in Section 5.5 are key priorities for FICC firms (fine-tuning performance measures; adjustments to remuneration; attitudes towards hiring, promotion and advancement; closer board involvement in governance of FICC activities; and clearer front line responsibilities)? What specific solutions to these challenges have worked well, or could work well? And how best can the authorities help to support these initiatives?

Response n/a.

Q38. To what extent could the Banking Standards Review Council help FICC market participants to raise standards collectively — in particular, are there other steps that could be taken to help complement or extend this initiative in FICC markets for non-banks and internationally?

Please see our response to question 39.

Q39. Are there other regulatory measures the authorities could take to strengthen personal accountability or otherwise improve the way firms manage incentives and governance? In particular, should any or all of the measures in the Senior Managers and Certification regime be extended to non-bank firms active in FICC markets?

Regulated participants of spot FX markets are already subject to existing and incoming regulations relating to governance and accountability; we also support further clarification of governance and accountability of Senior Managers via a strengthened voluntary code drawn up by consultation with and input from all types of practitioners across the spot FX community to ensure that the resulting code was both appropriate in design, and also able to be implemented by the market as a whole.

Q40. What role can more effective surveillance and penalties for wrongdoing play in improving the fairness and effectiveness of FICC markets globally? How can firms and the industry as a whole step up their efforts in this area? And are there areas where regulatory supervision, surveillance or enforcement in FICC markets could be further strengthened?

More effective surveillance and penalties for wrongdoing will improve significantly the perception of fairness and effectiveness of FICC markets globally. If markets have the perception of being "cleaner"

they will naturally grow as they will attract more participants. This in turn will bring greater liquidity, more product innovation and strengthened economies

Q41. How can firms increase the effectiveness of their own surveillance efforts across FICC markets globally? What role could the industry play in helping to explore best practices on how to make whistle blowing and other similar regimes more effective? Is there scope to make greater use of large scale market data sets and electronic voice surveillance to help detect cases of abuse in FICC markets? Are there other potentially effective tools?

Thomson Reuters supports mechanisms that ensure instances of misconduct are reported appropriately, e.g. via firms' own internal escalation policies. In addition, surveillance tools can include automated systems or electronic voice surveillance depending on the nature of the trading in question. The tools are only part of the question though; it is also clearer reporting obligations and threats of potential enforcement that will have the bigger impact.

Q42. Are there processes or structures that can allow firms to punish malpractice by their own staff more effectively (for example, penalties for breaching internal guidelines)?

All firms that are active in FICC markets should establish internal guidelines on standards of behaviour, and address malpractice by their own staff as per their internal disciplinary procedures. These may include dismissal and reporting malpractice to a regulatory authority or law enforcement agency.

Q43. Could firms active in FICC markets do more to punish malpractice by other firms, for example by shifting business and reporting such behaviour to the authorities?

Response n/a.

Q44. Is the current supervisory approach and level of intensity dedicated to supervising conduct within the UK wholesale FICC markets appropriate?

Response n/a.

Q45. Are there ways to improve the data on FICC market trading behaviour available to the FCA, whether through the extension of the regulatory perimeter or otherwise?

It is critical that the full implications of extending the regulatory perimeter are considered and that the full impact of the associated costs to all the members of the community, including end users, are examined.

Q46. What further steps could regulators take to enhance the impact of enforcement action in FICC markets?

More clarity and definition relating to market abuse and punitive measures in relation to spot FX markets should be agreed in strengthened industry codes. These should define processes to enable suspicious transaction reports relating to spot FX to be submitted to an appropriate authority to be

further investigated, with mechanisms for providing feedback to reporting firms to assist with further monitoring.

Q47. Should consideration be given to greater use of early intervention, for example, temporary suspension of permission for a particular trading activity for firms or individuals or increased capital charges?

The response to this question relates solely to FX markets. We believe the Review should consider this topic very carefully; the impact of temporary suspension could have far reaching effects on the liquidity of the markets, and therefore impede currency flows. Our view is that suspension should be an enforcement measure implemented only once a proper enforcement process has taken place.

Q48. Is there a need to widen and or strengthen criminal sanctions for misconduct in FICC markets?

Response n/a.

Q49. Is the approach set out in the Criminal Sanctions Market Abuse Directive appropriate for the United Kingdom? Are there additional instruments or activities to those envisaged by the Directive that should be covered by the domestic criminal regime?

Response n/a.