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ACI – The Financial Markets Association (ACI)

Official Feedback to the FSB Benchmark Consultative Document

Prepared by ACI Foreign Exchange Committee and the International Secretariat of ACI – The Financial Markets Association

This paper is the result of considered debate amongst the members of the ACI Foreign Exchange Committee (ACI FXC) and is intended to provide our unbiased replies to the issues discussed in the FSB Consultation on Benchmarking, written and distributed by the Foreign Exchange Benchmark Group. The ACI welcomes the opportunity to engage with the FSB on this subject. The ACI believes that the debate about the role of benchmarks and the use of benchmarks in the FX market is a positive development, and should take place in a public forum. The benefits of transparency on the debate are numerous, and include the need for the public to understand the complexity of the creation and monitoring of benchmarks, the reasons for the extensive use of benchmarks by "buy-side" participants, and the service provided by "sell-side" participants to these clients. For this reason, the FSB Consultative document, and the responses from the various market participants to the document, will help the regulators, industry participants and the public to be better educated on the structure and uses of the foreign exchange market. The greater awareness that comes from this knowledge will assist the industry in assuring that best practices are followed.

The ACI also appreciates the clarity with which the FSB Consultative Document was written, and thanks the authors for the manner in which the document was prepared. The ACI believes that the Consultative Document accurately reflects the way in which the FX market functions. Summaries of the creation of the benchmarks and their methodologies, the reasons for the use of benchmarks and the fixing rates deployed by "buy-side" participants, and the methods of risk mitigation deployed by sell-side" participants are well produced. This unbiased reflection of the current state is helpful to the industry overall.

Importantly, the ACI welcomes the elevated importance that the Consultative Document places on the behaviour of market participants. The FSB Consultative Document reflects the need for individual behaviour to be held to the highest standards of ethical conduct, and mentions the ACI Model Code.

The ACI is firmly of the belief that the Model Code should be adopted formally by the industry on both the “buy-side” and the “sell-side” and applied across the globe. As is stated by the FSB Consultative Document, for codes of conduct to be effective they must be adhered to. The use of a single, globally recognised, industry-wide, unbiased code, that addresses the specific issues of the foreign exchange market will provide a tremendous amount of value to this problem. Disseminating the information and training staff on the uses of the sections of the Model Code is a minimum requirement for market participants. The ACI strongly endorses the application of the Model Code to the benchmarking issues addressed in the FSB Consultative Document. The ACI also reminds the reader that the Model Code makes a clear statement about the responsibilities of management and supervisors to ensure that codes of conduct are adhered to. Single-platform (company) and national/regional codes may sit alongside a global code, but there should be few (if any) differences in the application of these codes on market practice. Any differences increase the risk of ethical arbitrage amongst market participants, and give rise to the issues about which the Consultative Document was written.

The ACI responses to the individual draft recommendations are as follows:

1. **The group recommends the fixing window be widened from its current width of one minute. It seeks feedback from market participants as to the appropriate width of the window**

   Observations:

   The widening of the fixing window would make it less likely that a large volume of business would create market price distortions, as the sourcing of liquidity would be more reflective of a normal market.

   A wider time window would make price manipulation more difficult (involve far greater risk) and would therefore reduce the likelihood of manipulation.

   The move to a wider window would not impact the “principal vs agency” question.

   The normal distribution of volumes per currency does not differ substantially between liquid or illiquid currencies

   ACI Proposition: It should be 5 minutes for all currencies and all attendees agree with the recommendation.

2. **The group seeks feedback from market participants as to whether there is a need for alternative benchmark calculations such as a volume weighted or time weighted benchmark price calculated over longer time periods up to and including 24 hours.**

Observations:

There are a sufficient number of services providing this already, yet they have yet to be proven effective, and have therefore not been deployed by the market. Deployment of alternatives should be at the commercial discretion of any entity using such a method. The use of volume or time-weighted benchmark calculations (VWAP or TWAP) would require a significant repurposing of legal documents, client contracts, performance measurement agreements and other legal concerns, and is a potentially costly exercise without benefit.

Unlike exchange-traded (limited open hours) markets, the 24-hour nature of FX reduces the effectiveness of VWAP and TWAP.

ACI Proposition: An alternative benchmark isn't needed.

3. **The group also seeks feedback from market participants as to whether the fixing window should continue to be centered exactly on the hour (half hour) or whether the fixing window should close or start on the hour. Market participants should consider whether this view changes dependent on the size of the window.**

Observations:

There is no significant difference between a half hour and an hour.

There is the risk of a time change reducing the liquidity as fewer participants may be present.

ACI Proposition: An alternative fixing time window is not needed.

4. **The group proposes that WM investigate the feasibility of receiving price feeds and transactions data from a broader range of sources to further increase its coverage of the FX market during the fixing window, and should regularly check its coverage as market structure continues to evolve. In that regard, the group also proposes that in the short term, WM develop its methodology to utilize the transactional quote and information from both Thomson Reuters and EBS.**

Observations:

There is a distinction between primary and secondary sources in the validity of pricing feeds. These feeds must provide a good reflection of the actual market conditions.

To get a true aggregate price over time window, one needs to consider incorporating as many platforms as is feasible. The inter-bank market no longer exists in the same form as before, so pricing feeds must include all sources. To determine what the price is trading at, we need to include a practical number of the multi-contributor venues* as well as including the multilateral platforms. The aim is to represent a price where the vast majority of the business is being done.

ACI Proposal: There should be more venues as practically possible. A high number of mid-point prices, from as many venues, multi bank venues or multi contributing venues would provide the optimal view of the prevailing market price.

The ACI recognizes that given the current 'WMR' fix investigations that this recommendation may appear controversial. However, the ACI is confident that with enhanced enforcement of internal and external compliance guidelines and the adoption of 'codes of conduct' regarding best practices in FX by all market participants, the inclusion of price feeds and transaction data from a broad range of sources is prudent.

5. **The group considers that, where central banks publish reference rates, it is the responsibility of each to set internal procedures. Central banks should at least take note of the guidance from the IOSCO principles. However, where central bank reference rates are intended for transaction purposes. In that respect, transparency in governance and computation methodology would meet expected public demand and reinforce the credibility of the relevant reference rates.**

   ACI Proposal: ACI agrees with the proposal.

6. **The group supports the development of industry-led initiatives to create independent netting and execution facilities. However, it is also interested in seeking feedback from market participants on the development of a global/central utility for order-matching to facilitate fixing orders from any market participants.**

Observations:

Any new global/central utility (such as CCPs) may bring about new risks and new unintended consequences that need to be understood by the market. While there has been tremendous benefit derived from the use of such utilities, for example, credit risk mitigation from CLS and STP transparency benefits of CCPs; nevertheless, any new central utility for order-matching must be thoroughly understood.

The FX market currently functions extremely efficiently in a combination of forms, but remains predominantly an OTC market for good reasons. The plethora of pricing-matching opportunities currently reflects the distribution of credit risk, the commercial interests of global, regional and other specialist participants, and incorporates a healthy balance of risks that are understood by market participants. Having a central utility would create enormous single-point of failure risks.

Choice as to participation on existing utilities is made largely for participants for their own individual commercial reasons. Such choice must be left to participants in an open market.

ACI Proposal: ACI recognize the value of specific utilities for their specific purposes, but support a global free market for trade execution. A concentration in a single global point for trade matching would in the event of failure pose a significant risk for the market.

7. **The group recommends that fixing transactions be priced in a manner that is transparent and is consistent with the risk borne in accepting such transactions. This may occur via applying a bid-offer spread, as is typical in FX transactions, or through a clearly communicated and documented fee structure such as a direct fee or contractually agreed price.**

Observations:

A certain number of banks are developing or have developed matching engines, and are building these matching engines around fixings, for the purposes of moving to an agency-based approach.

An Agency fee can be a good reflection of the costs and risks borne by the price-maker. However, an Agency model must be pure, and not act as an additional fee to any principal activity. Any business transacted on an Agency model must be separated from principal activity and be clearly documented and handled as such.

The use of an Agency model may distort pricing, as the contracted fees may not reflect the risks borne by the "sell-side" under varying market conditions.

The "buy-side" is already offered a choice of agency pricing or principal pricing, with some "buy-side" clients already agreeing to pay an additional price in exchange for "best execution" on certain trades. Formalising this into documents may create unintended consequences for this already-existing choice.

An Agency model does not, on its own, vary the ethical conduct concern. The banishment of front running, exchanging Material Non-Public Information and collusion must continue.

ACI Proposal: ACI agrees that it is perfectly possible for an agency / fee model based offering to coexist with a principal-based model, but concerned that clear delineation exists between the two. A risk-based, principal model still provides value for a majority of clients. The ACI believes that the "buy-side" should continue to have choice, and will adopt whichever model is required to allow both types to be deployed.

8. **The group recommends that banks establish and enforce their internal guidelines and procedures for collecting and executing fixing orders including separate processes for handling such orders.**

ACI Proposal: ACI agrees with the proposal

9. **Market-makers should not share information with each other about their trading positions beyond that necessary for a transaction. This covers both individual trades, and their aggregate positions.**

ACI Proposal: the venue should comply with internal company policies. It should not contain information about individual trades of other customers, nor should it include information of positioning of the fix. The market maker can be expected to advise the clients of the state of the market.

10. **Market-makers should not pass on private information to clients or other counterparties that might enable those counterparties anticipate the flows of other clients or counterparties, especially around the fix.**

Observations:

The definition of private information should be made clear and adopted as standard by the industry.

ACI Proposal: a definition of private information is needed or a possible change of the word 'private information' to confidential information, which is defined in the Model Code.

11. **More broadly, the group recommends that banks establish and enforce their internal systems and controls to address potential conflicts of interest arising from managing customer flow.**

Observations:

Clarity and transparency on the codes of conduct for dealing are advantageous. The education of best practise for both the "buy-side" and the "sell-side" is important to the proper functioning of the market.

Participants are currently "frozen" by the lack of information on the investigations, and are seeking clarity on the definitions of acceptable behaviours.

The "buy-side" benefits from knowing the codes of conduct of the "sell-side" and can reassure their investors that they are playing a role in improving ethical culture in the industry by trading only with those "sell-side" institutions that are compliant with proper codes.

Work currently taking place to further harmonise the various codes of conduct is very helpful in reducing the risk of ethical arbitrage, and in fostering a functioning market. The harmonisation should reflect the work done by the ACI Committee for Professionalism, and extend the work already done in the Central Bankers' FX Committee's "Global Preamble" to place high value on the ACI Model Code.

ACI Proposal: ACI recommends all market participants adopt the ACI Model Code. The ACI recommends this adoption be global and formally recognized across the industry, including the various regulators, as an excellent effort to provide the guidance required by the market. The ACI further seeks open endorsement of its well-regarded suite of education products, as the focus on best practise and ethical behaviour is at the centre of this work.

12. **Codes of conduct that describe best practices for trading foreign exchange should detail more precisely and explicitly the extent to which information sharing between market-makers is or is not allowed. They also should, where appropriate, incorporate specific provisions on the execution of foreign exchange transactions including fixing orders.**

Observations:

The code of conducts are clear as to what you can and cannot do with confidential information, the current demand for guidance is for what you can and cannot do with aggregate information.

According to the ACI Model Code, the sharing of aggregate information is not forbidden, provided it is done in a manner as to not reveal any confidential client information. Aggregate information is essential for risk mitigation and risk management techniques.

Guiding principles from other regulators like IOSCO, FSB, etc. will be incorporated into the Model Code as they are published.

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13. **The group recommends stronger demonstration by market participants of compliance with the codes of the various foreign exchange committees, as well as their internal codes of conduct.**

ACI Proposal: ACI recommends all market participants adopt the ACI Model Code. The ACI recommends this adoption be global and formally recognized across the industry, including the various regulators, as an excellent effort to provide the guidance required by the market. The ACI further seeks open endorsement of its well-regarded suite of education products, as the focus on best practise and ethical behaviour is at the centre of this work.

14. **The group recommends that index providers in other markets should review whether the foreign exchange fixes used in their calculation of indexes are fit for purpose.**

ACI Proposal: ACI recommends full endorsement of this.

15. **The group recommends that asset managers, including those passively tracking an index, should conduct appropriate due diligence around their foreign exchange execution and be able to demonstrate that to their own clients if requested. Asset managers should also reflect the importance of selecting a reference rate that is consistent with the relevant use of that rate as they conduct such due diligence.**

Observations:

The focus on asset managers is due to the variance in financial regulation. Asset managers are subject to financial regulation whereas corporate clients are subject to the international accounting standards. Accounting standards already have very detailed standards as to what is permitted and what is prohibited.

The fix is a perfect mechanism for those that want to do small parcels of FX at a fair rate and it is the duty of the banks that they quote correct prices and not try to make profit through unfair means.

ACI Proposal: ACI agrees with this proposal. Appropriate due diligence should be conducted.