Investment Management Association

ima

Foreign Exchange Benchmark Group
Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Re: IMA response to FSB FX Benchmark Consultative Document

Dear Sir,

The Investment Management Association (the "IMA") welcomes the opportunity to respond to the FSB's FX benchmark consultative document.

The IMA represents the UK asset management industry. Our members manage over £5.0 trillion (€ 7.2 trillion/US$ 9.8 trillion) in the UK of assets on behalf of UK, European and International clients, both retail and institutional. Collectively, our members make up the second-largest asset management industry in the world.

IMA member firms are the major users of the FX benchmarks, particularly the WM/Reuters fixing, for a variety of uses such a valuing, transferring and re-balancing multi-currency asset portfolios. Crucially, the WM/R fixings are embodied within some investment mandates run by asset managers, making the fixings an integral part of our ability to manage client portfolios.

Notwithstanding conduct and calculation issues, the WM/R 4:00pm fixing continues to be a relevant and in principle appropriate benchmark for the valuation of assets.

Below, we have provided our responses against the key recommendations of the FX Benchmark Group (the "Group").

If you have any questions or comments, do not hesitate to contact us.

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Recommendation 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.

The IMA agrees with the recommendation to widen the time window to a limited extent. We note that the main risk of market failure to date appears to be in relation to activity *ahead* of the window, rather than during it, in which case the width of the window will not be the primary concern. Also, the wider the window, the more data points that will need to be reflected by any entity or platform that accepts an order for execution at the fix rate. Moreover, a wider window would have a greater chance of being affected by data releases or major news. Having said which, a wider window may make it easier to accommodate a broad range of orders in large aggregate size, which is itself a desirable objective. That, however, in turn makes it important to ensure that an effective execution mechanism is in place, as addressed in Recommendation 6.

If it is in fact decided to widen the window significantly, we believe that it should suffice to extend it to 20 minutes and certainly no more than 30-minutes, 15 minutes either side of 16h00, i.e. **a maximum window width of between 15h45 and 16h15 London time**.

Recommendation 2

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

The IMA believes that it will only become relevant to consider alternative benchmark calculations once a trading mechanism is established.

Recommendation 3

The group seeks feedback from market participants as to whether the fixing window should continue to be centred 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.

Please see response to recommendation 1. In principle, we see no reason to move the central time point.

Recommendation 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 assess 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 utilise transactional and quote information from both, Thomson Reuters and EBS.

The IMA supports this recommendation.

Benefits will exist from additional sources of liquidity for calculation purposes and users would derive a degree of reassurance that the fixing is a true reflection of the activity being traded. This may be particularly true for those currencies that are relatively illiquid.

It will, however, be important to ensure that trading data sourced is from truly liquid venues. As with other asset classes, venues with high intraday turnover may prove to lack capacity to absorb the large orders that are sometimes inherent in asset management.

Recommendation 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 guidance from the IOSCO principles. However, where central bank reference rates are intended for transactional purposes, the group encourages compliance with the relevant IOSCO principles. In that respect, transparency in governance and computation methodology would meet expected public demand and reinforce the credibility of the relevant reference rates.

Where central bank reference rates are intended for transactional purposes, compliance with the relevant IOSCO principles must be mandatory.

Recommendation 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.

The IMA agrees with this recommendation.

Establishing independent netting and execution facilities will help to mitigate conflicts of interest and introduce a greater degree of transparency. With that said however, such an independent entity will not be easily created, because of the scope of issues likely to arise around the breadth of participation and the fees needing to be charged.

Such an independent entity may be established with an intraday auction (around 4:00pm London time), which would net offsetting flows and then execute the residual orders using a pricing mechanism that determines the clearing price against liquidity providing orders or orders within the order books of relevant platforms.
Finally, as a matter of course, such a solution will need the support of index providers or the benchmark agencies, otherwise tracking errors may emerge.

Recommendation 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.

We accept in principle that any entity accepting an order may be taking on market risk and may reasonably seek some compensation for taking this risk, for example in the form of a bid-offer spread. Any entity that did not charge for taking on the risk (notably by offering the mid rate instead of the bid/offer) would tend to run at a loss and so be incentivised to generate returns in other ways that could ultimately work against the interests of clients. Having said which, such conflicts are not necessarily eliminated by the mere presence of compensation and would therefore still have to be managed and policed (while end-customers would also need to be properly informed as to both the compensation and conflicts management involved). We therefore see the establishment of an effective netting-cum-execution mechanism and a carefully calibrated window width as the key measures to focus on.

Recommendation 8
The group recommends that banks (and other FX dealing intermediaries) establish and enforce their internal guidelines and procedures for collecting and executing fixing orders including separate processes for handling such orders.

The IMA agrees with this recommendation.

Recommendation 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.

The IMA agrees with this recommendation.

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

The IMA agrees with this recommendation. We note that it will be important to specify clearly what is meant by 'private information'.

Recommendation 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. For example, separating trading activity for clients from own trading. The group was told that a number of institutions are initiating changes in this regard.

The IMA agrees with this recommendation.

Recommendation 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.

Such codes of conduct are helpful but not sufficient. Legally-binding rules and/or guidance need to be put in place to ensure that market/confidential client information is not shared between market-markers (except, of course, for the information required to transact). Such enforceable rules/guidance must come equipped with appropriate sanctions.

Recommendation 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.

Please see our response to recommendation 12.

Recommendation 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.

The IMA agrees with this recommendation.

Recommendation 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 due diligence.

The IMA agrees with this recommendation, while noting (for the avoidance of doubt) that it is the clients of asset managers – rather than the asset managers themselves – that bear the ultimate decision-making power, with regard to choice of benchmarks.

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