UK: Fair and Effective Markets Review

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**Background to Fair and Effective Markets Review ("FEMR")**

FEMR set up jointly by the Bank of England, HM Treasury and FCA in October 2014.

- Scope of the Review covered the Fixed Income, Currency and Commodities markets ("FICC").

- Misconduct issues and the casual attitude of traders towards the abuses they were perpetrating.

FEMR’s work to be guided by three principles:

- outcomes should be market-led where possible;

- the recognition that markets are global in scope and shaped by forces wider than those in the UK; and

- that there is no single FICC market.
“Fair” and “Effective”

“Fair” markets are those that have clear standards of market practice, transparency and open access; allow market participants to compete on the basis of merit; and provide confidence that participants behave with integrity.

“Effective” markets are those which enable market participants to trade at competitive prices; and allow ultimate end-users to undertake investment, funding, risk transfer and other transactions in a predictable fashion underpinned by robust infrastructure.

Six sources of vulnerability were identified for assessment:

- market microstructure
- competition and market discipline
- benchmarks
- standards of market practice
- responsibilities, governance and incentives
- surveillance and penalties
Consultation set out 49 questions for consideration under the six areas identified above.

A Market Participant Panel was established to focus on producing a coordinated response across the industry.

The consultation paper acknowledged at the outset that:

- where areas of improvement are identified, this could happen either through action on the part of markets, firms, individuals or regulators.

- raising standards of behaviour was important as well as the role that industry could play in establishing such standards.

- some legislative measures are already in train such as MiFID/R, MAD2 and EU Benchmark legislation.
Some observations from the Final Report:

- “ethical” drift in the market.

- assumption that market discipline would play a primary role in policing conduct i.e. withdrawal of business by counterparties.

- need for more forward-looking approach to conduct risk and mitigation.

- need for greater clarity and understanding of market-wide standards for trading practices and strong adherence by firms and individuals to those standards.

- ineffective whistleblowing procedures.
FEMR Recommendations

Some of the recommendations are international in scope:

- the development of globally endorsed common standards for trading practices in the FICC markets, in language that can be readily understood and consistently upheld. IOSCO is encouraged to promulgate this on an international basis.

- the creation of a permanent FICC Markets Standards Board with participation from a broad range of firms and end users at senior levels and involving regular dialogue with authorities. It should aim to have international reach through its private membership. It should scan the horizon and report on emerging risks where market standards could be strengthened.

- agreeing a single global FX code including principles to govern trading practices and standards for venues.

- examine ways to improve the alignment between remuneration and conduct risk at a global level.
Near term actions to improve conduct in FICC Markets:

1. Raise standards, professionalism and accountability of individuals
   a. Develop a set of globally endorsed common standards for trading practices in FICC markets, in language that can be readily understood, and which will be consistently upheld;
   b. Establish new expectations for training and qualifications standards for FICC personnel, with a requirement for continuing professional development;
   c. Mandate detailed regulatory references to help firms prevent the ‘recycling’ of individuals with poor conduct records between firms;
   d. Extend UK criminal sanctions for market abuse for individuals and firms to a wider range of FICC instruments; and
   e. Lengthen the maximum sentence for criminal market abuse from seven to ten years’ imprisonment.

2. Improve the quality, clarity and market-wide understanding of FICC trading practices
   a. Create a new FICC Market Standards Board with participation from a broad cross-section of global and domestic firms and end-users at the most senior levels, and involving regular dialogue with the authorities, to;
      – Scan the horizon and report on emerging risks where market standards could be strengthened, ensuring a timely response to new trends and threats;
      – Address areas of uncertainty in specific trading practices, by producing guidelines, practical case studies and other materials depending on the regulatory status of each market;
      – Promote adherence to standards, including by sharing and promoting good practices on control and governance structures around FICC business lines; and
      – Contribute to international convergence of standards
3. Strengthen regulation of FICC markets in the United Kingdom

a. Extend the UK regulatory framework for benchmarks to cover several additional major UK FICC benchmarks – accepted and implemented by HM Treasury on 1 April 2015;
b. Create new statutory civil and criminal market abuse regime for spot foreign exchange, drawing on, among other things, work on a global code (see recommendation 4a);
c. Ensure proper market conduct is managed in FICC markets through monitoring compliance with all standards, formal and voluntary, under the Senior Managers and Certification Regimes;
d. Extend elements of the Senior Managers and Certification Regimes to a wider range of regulated firms active in FICC markets; and
e. Improve firms’ and traders’ awareness of the application of competition law to FICC markets.

4. Launch international action to raise standards in global FICC markets

a. Agree a single global FX code, providing: principles to govern trading practices and standards for venues; examples and guidelines for behaviours; and tools for promoting adherence. The Review strongly welcomes the recent announcement by central banks to work towards those goals;
b. As part of that work, improve the controls and transparency around FX market practices, including ‘last look’ and time stamping;
c. Explore ways to ensure benchmark administrators publish more consistent self-assessments against the IOSCO Principles, and provide guidance for benchmark users; and
d. Examine ways to improve the alignment between remuneration and conduct risk at a global level.
5. Promoting fairer FICC market structures while also enhancing effectiveness, through:

a. Improving transparency in ways that also maintain or enhance the benefits of diverse trading models, including over-the-counter;
b. Promoting choice, diversity and access by monitoring and acting on potential anti-competitive structures or behaviour; and
c. Catalysing market-led reform held back by private sector co-ordination failures.

6. Forward-looking conduct risk identification and mitigation, through:

a. Timely identification of conduct risks (and mitigants) posed by existing and emerging market structures or behaviours;
b. Enhanced surveillance of trading patterns and behaviours by firms and authorities; and
c. Forward-looking supervision of FICC markets.
What next?

- An Open Forum will be held in Autumn 2015 to enable stakeholders to discuss the recommendations.


- FICC Market Standards Board will be established.

- Will progress on global standards be undertaken by IOSCO?

- Will the FSB examine further ways to improve alignment between remuneration and conduct risk at a global level?

- If firms and staff fail to take the opportunity to improve then more restrictive regulation is inevitable.