FOREIGN EXCHANGE BENCHMARKS

ICAEW welcomes the opportunity to comment on the consultation paper *Foreign Exchange Benchmarks* published by the Financial Stability Board on 15 July 2014, a copy of which is available from this link.

We note this consultation paper is subject to a short consultation period, which inherently limits the ability of ICAEW to draw together resources from our extensive network of members in preparing our response, especially over the summer holiday period. As such, our response is limited in certain aspects.

This response of 12 August 2014 has been prepared on behalf of ICAEW by the Financial Services Faculty. As a leading centre for thought leadership on financial services, the Faculty brings together different interests and is responsible for representations on behalf of ICAEW on governance, regulation, risk management, auditing and reporting issues facing the financial services sector. The Faculty draws on the expertise of its members and more than 25,000 ICAEW members involved in financial services.

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ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

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MAJOR POINTS

Support for the initiative

1. We support the initiative of the Financial Stability Board in examining how foreign exchange benchmarks may be improved. We believe greater credibility and integrity of benchmarks can be achieved through formalising the way in which benchmarks operate.

2. ICAEW's priority in this area is how the work of assurance providers can help support confidence in financial benchmarks. To this end ICAEW has published *Assurance reports on benchmarks and indices*[1]*.* If you wish to further discuss this guidance, or anything contained within this response, please email fsf@icaew.com.

Conduct and behaviour

3. Existing market abuse rules, both at a domestic and European level can be interpreted as relevant to participants in the foreign exchange market. We anticipate that regulators will reach similar conclusions regarding foreign exchange to those that have been reached regarding interest rate benchmarks such as LIBOR. Assurance and enhanced governance requirements which emphasis responsibility and accountability, both of institutions and individuals are likely to be required.

4. A principles based code of conduct will provide clear guidance on allowable trading practice and desirable governance arrangements for market participants. In any such code particular weight should be given to conduct surrounding the dissemination of client information (including order information) with other market participants or anyone outside of the bank. Such a code should be the responsibility of the benchmark administrator and be enacted without undue delay. However, we acknowledge that the implementation of any such code will be time consuming and costly for institutions affected, but this does not diminish its necessity.

RESPONSES TO SPECIFIC PRINCIPLES

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 calculation window.

5. ICAEW is not a market participant, however we question whether widening the window would positively influence behaviour which occurs closer to the fix, without changing the definition on how the benchmark is actually calculated. This is further considered in our response to principle 4.

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 of up to and including 24 hours.

6. ICAEW is not a market participant, and we do not propose to provide feedback on this particular principle.

3. The group also seeks feedback from market participants as to whether the fixing windows 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 depending on the size of the window.

7. ICAEW is not a market participant, and we do not propose to provide feedback on the technicalities of this particular principle. However, we believe the integrity of benchmarks could

[1] http://www.icaew.com/~/media/Files/Technical/technical-releases/financial-services/tech02-14fsf-assurance-reports-on-benchmarks.pdf

be enhanced through further "post submission" analytical controls over trading within the fixing window, and order execution rather than changing the timing of the window.

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 the transactional and quote information from both Thomson Reuters Matching and EBS, wherever both are available.

8. We support the need for administrators to regularly assess their coverage as the relevant market evolves to ensure benchmarks reflect the underlying market and are fit for purpose in terms of their original definition.

9. We are not certain that expanding methodology to consider what would be classed as "data from other relevant markets" will necessarily enhance the integrity of the benchmark, as much of the market is already included. It should be borne in mind that (as was noted with LIBOR), changing methodology can change the definition of this benchmark. This can have a range of consequences including causing issues in contract law for users whose contracts reference the benchmark, and be time consuming and costly to enact which will impact the market.

10. Focus should be dedicated to enhancements which make the benchmark methodology more transparent and robust. This reduces the ability of market participants to manipulate benchmarks to their own advantage.

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 transaction purposes, the group encourages compliance with the relevant IOSCO principles.

11. We agree that central banks should look to the IOSCO principles for guidance when setting their own processes for publishing reference rates. We believe the principles can be a good basis for all types of organisations which set benchmarks, not simply commercial organisations. We believe the principles are also applicable to consensus pricing services, who publish many reference pricing benchmarks and indices.

6. The group supports the development of industry-led initiatives to create independent netting and execution facilities. However, it also is 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.

12. ICAEW is not a market participant, and we do not propose to provide feedback on this particular principle.

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.

13. As discussed in our previous points, a principles based code of conduct will enhance transparency through the articulation of acceptable practice and should include what client information if any, is allowed to be disseminated outside of the bank. There is a role for both the bank (more in-depth analytical review of client order acceptance vs execution for example) and the administrator. Together this should enhance the ability of users to know that their order is fairly placed and receives best execution. In order to make this demonstrable (whether to the market, regulators or assurance practitioners) an increased focus on record retention and submission processes will be required.

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.

14. We agree that banks must establish and enforce their internal guidelines for fixing orders, however, we are not placed to comment on whether this is best done as an entirely separate process or not.

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.

15. We agree. This would be considered a conflict of interest, management and avoidance of which would be part of any code of conduct. Please see our comments relating to principle 11 below.

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, including around the fix.

16. We agree. This would be considered a conflict of interest, management and avoidance of which would be part of any code of conduct. Please see our comments relating to principle 11 below.

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.

17. We strongly agree that banks establish and enforce systems and controls to address potential and actual conflicts of interest. Such controls and processes can be subject to external assurance an example of which can be found in our previously cited guidance in Appendix 1 to Section 6.

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.

18. We agree, though we would question whether individual entity codes of conduct are well placed to describe best practice, as consistency may be lacking. A code is perhaps best articulated by the benchmark administrator (and should be accessible to all benchmark users). We would encourage the FSB to consider the responses shared in relation to this principle, as well as future output from regulators currently investigating the foreign exchange market.

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.

19. We agree that market participants should demonstrate their compliance with their own code of conduct as well as adopted industry standards (for example the IOSCO principles or regulatory standards adopted in the future). In order to meaningfully demonstrate compliance we believe an independent, public assurance would be necessary.

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

20. We agree that index providers should have a duty to review whether the fixes they use are fit for purpose on a regular basis, and that this should be formally documented.

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.

21. There is a responsibility of the benchmark administrator to clearly articulate the purpose of their benchmark and how it reflects the underlying market, and of the asset manager to be able to demonstrate they are using the most appropriate rate for their customers' needs. Due diligence could take many forms, including the asset manager seeking assurance over the reference rates selected and that its selection is in keeping with their policies, which would likely form the basis of customers selecting that particular manager.