Global Foreign Exchange: Cracking the Code

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Abstract: The Foreign Exchange Global Code comes to the fore against a backdrop of ethical drift, which has affected the Foreign Exchange markets of late. In précising recent market scandals, this article shall outline why the Global Code is needed, before assessing the drafts which emerged out of the Code's first and second developmental phases in May 2016 and May 2017 respectively. Under particular scrutiny will be their substantive content, the parties which contributed to their drafting, and the strategies being proposed for the Code's implementation.

Keywords: Financial Markets; Transnational Economic Governance; Financial Regulation; Networked Governance; Foreign Exchange

Introduction

Beset by a state of what has been referred to as "ethical drift", which has encouraged profit-maximisation at the expense of moral considerations to the contrary,[1] the foreign exchange (FX) market has occasionally been subject to scandalous activity of late. It is hardly surprising therefore that the Bank of International Settlements' announcement of a "Foreign Exchange Global Code" has been welcomed by industry players—the first phase of which came to fruition in May 2016,[2] followed by the second (and final) phase in May 2017.[3]

Pioneered by the Foreign Exchange Working Group (FXWG), whose work is informed by a set of member institutions and also a group of market participants, the Code is stated to be a "common set of guidelines to promote the integrity and effective functioning of the wholesale foreign exchange market".[4] Semantic implementation of the word "guidelines" here is rather apt since FXWG chairman Guy Debelle is adamant that "[t]he Code will be principles-based—rather than rules-based—and will provide guidance on what is, as well as what is not, appropriate behaviour for practitioners in the FX market".[5] The reasoning behind this is simple: the Code's aim of affirming best practice norms within the culture of applicable entities is distinctly holistic and thus is hardly something which can be enforced or mandated by hard-law.[6]

[1] Bank of England, "Rebuilding Trust through the 'FX Global Code': Reasons for optimism", Speech given by Chris Salmon, ACI UK Square Mile Debate (London: 21 September 2016), p.2 available at: http://www.bankofengland.co.uk/publications/Documents/speeches/2016/speech924.pdf [Accessed 31 May 2017].

[2] Bank for International Settlements, FX Global Code: May 2016 Update (Phase 1 Material for Global FX Code, May 2016) available at: http://www.bis.org/mktc/fxwg/gc_may16.pdf [Accessed 31 May 2017].

[3] Global Foreign Exchange Committee (GFXC), FX Global Code (May 2017) available at: http://www.globalfxc.org/docs/fx_global.pdf [Accessed 31 May 2017].

[4] Bank for International Settlements, FX Global Code: May 2016 Update (2016), p.2.

[5] Bank for International Settlements, "Working group to strengthen code of conduct standards and principles in foreign exchange markets has commenced work", Press Release (24 July 2015) available at: http://www.bis.org/press/p150724.htm [Accessed 31 May 2017].

[6] Chatsworth communications, "BIS FX Code of Conduct Offers Reasons for Optimism" (26 September 2016) available at: http://www.chatsworthcommunications.com/bis-fx-code-of-conduct-offers-reasons-for-optimism/ [Accessed 31 May 2017].

Procedurally, implementation of the Code in a certain jurisdiction shall "take account of"[7] the applicable law operable there since it is "intended to serve as a *supplement* to any and all local laws, rules, and regulation"[8] as opposed to *supplanting* them outright. The Code will operate on a soft-law echelon clearly delineable from the ratio decidendi, tasked instead with harmonising the preponderance of regional FX codes littering the industry at present, thus facilitating "a harmonised set of best practices that can be applied internationally".[9]

At ground level, the Code shall provide a yardstick by which a participant can "review the adequacy and completeness of … [its] current internal compliance materials related to the operation of its FX business".[10] Compliance will be contingent upon the ability of said participant "to document a policy or procedure in furtherance of each of the Global Code's principles".[11] The rationale for the Code is thus undoubted in attempting to "encourage good practice and re-build public confidence"[12] so that industry players "are able to confidently and effectively transact at competitive prices that reflect available market information".[13]

Nature of the foreign exchange market

Prior to embarking upon substantive exploration of the Code itself, it will be fruitful to first ascertain the significance and nuances of the market upon which it is based. The FX market as we know it today is the culmination of various international monetary policy reforms dating back to

[7] GFXC, FX Global Code (2017), p.5.
[8] Bank for International Settlements, FX Global Code: May 2016 Update (2016), p.2.
[9] Euromoney, "FX: Restoring trust—the global code is here" (July 2016) available at: http://www.euromoney.com/Article/3512558/FX-Restoring-trustthe-global-code-is-here.html [Accessed 31 May 2017].
[10] M. Kulkin, M.S. Green and C.R. Mills, "FX Global Code of Conduct May Raise Compliance, Disclosure Issues for Market Participants" (Global, Steptoe & Johnson LLP, 7 June 2016), Lexology available at: http://www.lexology.com/library/detail.aspx?g=acd68a18-345f-46d4-b1ee-581638be063e [Accessed 31 May 2017].
[11] Kulkin, Green and Mills, "FX Global Code of Conduct May Raise Compliance, Disclosure Issues for Market Participants" (7 June 2016), Lexology.
[12] Peter Garnham, "FX industry welcomes global code of conduct" (13 June 2016), FX-MM available at: http://www.fx-mm.com/50439/blog/fx-industry-welcomes-global-code-of-conduct/ [Accessed 31 May 2017].
[13] Bank for International Settlements, FX Global Code: May 2016 Update (2016), p.2.

the mid-20th century. July 1944 saw the Bretton Woods Monetary and Financial Conference, a forum for Allied representatives to convene in order to discuss post-war monetary issues. Reforms arising out of the Conference included the fact that foreign currencies would subsequently be pegged to the US dollar and that the value of the dollar would in turn be contingent upon the price of gold. These proved to be unsustainable, however, as it soon became "impossible for individual countries to manage the value of their own currency"[14] since the dollar was itself succumbing to the volatility of gold prices. For example, sharp rises in the price of gold during the early 1970s were proving problematic for US inflation levels.[15] This, in turn, led to President Richard Nixon removing the stranglehold which gold prices had on the price of the US dollar, paving the way for currencies to float at market rates.[16] Combined with Britain's abolition on FX controls in 1979,[17] policy actions such as this facilitated the conception of the FX market as we now know it.

The foreign exchange market today

The FX market has remained a stalwart of global finance. Boasting business volumes of an estimated $5 trillion per day,[18] movements in exchange rates resulting from FX activity are of sufficient magnitude to impact upon inflation, the balance of trade[19] and also the vitality of businesses on the ground. Constituting more than a third of the FX market's aggregate volume is

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[14] OANDA, "Evolution of an Open Forex Market" available at: https://www.oanda.com/forex-trading/learn/intro-to-currency-trading/currency-market/evolution [Accessed 31 May 2017].
[15] OANDA, "Forex Training Summary" available at: https://www.oanda.com/forex-trading/learn/intro-to-currency-trading/currency-market/summary [Accessed 31 May 2017].
[16] J. Markham, "Regulating the Moneychangers" (2016) 18 University of Pennsylvania Journal of Business Law 789, 807.
[17] K. Lander and R. Preece, "Finance briefing: Foreign exchange market and why it matters" (6 April 2014), Financial Times available at: https://www.ft.com/content/a3b9e74c-ba6f-11e3-aeb0-00144feabdc0 [Accessed 31 May 2017].
[18] Bank for International Settlements, "Triennial Central Bank Survey of foreign exchange and OTC derivatives markets in 2016" (Statistics, 11 December 2016) available at: http://www.bis.org/publ/rpfx16.htm [Accessed 31 May 2017].
[19] D. Zaky, "Forex Market Participants and Why They Trade Currencies" (24 October 2016), Fxdailyreport.com, Education available at: http://fxdailyreport.com/who-trades-forex-currency/ [Accessed 31 May 2017].

the UK,[20] with its Joint Standing Committee announcing FX turnover of over $2.2 billion in April 2016 alone.[21] Another FX stronghold is the US, with almost 90% of daily trading volumes in 2013 said to comprise dollar trades,[22] whilst the remainder of the market is made up of countries including Singapore, Japan and Hong Kong.[23]

With specific regard to how such trades are facilitated, the FX market "performs an international clearing function by bringing two parties wishing to trade currencies at agreeable exchange rates".[24] This is logistically possible by virtue of the fact that parties need not meet in person; instead, transactions are undertaken over the telephone or by electronic means. In terms of overall structure, the FX market is double-faceted. For one, some of its characteristics are customary of perfect competition, such as its outputs which are homogeneous.[25] Secondly, although WM/Reuters provides the market with daily benchmark rates known as "fixes",[26] the final price of a FX transaction is arrived at following negotiations between the parties themselves[27] —with the market working to move the benchmark rate toward an agreed equilibrium. That said, however, also latent amongst market players are heterogeneous deviations, "including informational asymmetries, differing reaction speeds to information innovations, and diverse opportunity sets and risk-return expectations".[28] The presence of these deviations renders the FX market somewhat

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[20] Financial Conduct Authority, "Conduct risk in FX markets", Speech by Edwin Schooling Latter, Head of Markets Policy (London: FX Week Europe, 30 November 2016) available at: https://www.fca.org.uk/news/speeches/conduct-risk-fx-markets [Accessed 31 May 2017].

[21] The Foreign Exchange Joint Standing Committee, Results of the Semi-Annual FX Turnover Survey in April 2016 (April 2016) available at: http://www.bankofengland.co.uk/markets/Documents/forex/fxjsc/2016/fxturnresults160725.pdf [Accessed 31 May 2017].

[22] Iowa State University, "Foreign Exchange Market" available at: http://www2.econ.iastate.edu/classes/econ355/choi/fex.htm [Accessed 31 May 2017].

[23] Iowa State University, "Foreign Exchange Market".

[24] Iowa State University, "Foreign Exchange Market".

[25] N. Elrick, "Perfect Competition", p.2 available at: https://business-tes.wikispaces.com/file/view/Perfect+Competition+notes.pdf [Accessed 6 July 2017].

[26] Thomson Reuters, "WM/Reuters FX Benchmarks; Spot & Forward Rates Methodology Guide", Document Version 2 (January 2017) available at: http://financial.thomsonreuters.com/content/dam/openweb/documents/pdf/financial/wm-reuters-methodology.pdf [Accessed 31 May 2017].

[27] N. Elrick, "Perfect Competition" available at: https://business-tes.wikispaces.com/file/view/Perfect+Competition+notes.pdf [Accessed 31 May 2017].

[28] M.J. Sager and M.P. Taylor, "Under the Microscope: The Structure of the Foreign Exchange Market" [2006] International Journal of Finance and Economics 11, 81.

imperfectly competitive. Despite this, however, FX transactions have remained popular because of the returns to be gleaned from them both as standalone investments and "when combined in a portfolio with returns to more traditional assets, such as equities or bonds".[29]

Market participants

As for the people and institutions involved in FX trades, Pt II of the Code's Foreword exhaustively lists participants generally expected to be engaged in such activities; participants who in turn fall within the ambit of the Code. Listed first are financial institutions. An umbrella term predominated by banks, these are active in the FX market as both market makers for clients and as clients in their own right. Banks bring together buyers and sellers of a certain currency, acting as dealers aiming to make a profit on the bid-offer price spread.[30] In addition, banks undertake their own speculative trading exploits, the aim of which is to profit from changes in exchange rates.[31] Furthermore, a preponderance of bank-to-bank FX trading since the collapse of Bretton Woods[32] has led to an interbank FX sub-market. "[R]esponsible for the exchange rates which all other traders follow on their quote systems and trading platforms",[33] these banks "make currency transactions with each other on electronic brokering systems that are based on credit".[34] Taken together, banks therefore herald a multi-faceted interest in FX dealing.

The second organisation type listed on the Code's market participants list are central banks. Their engagement with FX is solely as a vehicle by which to increase or maintain the vitality of a currency. A central bank can artificially weaken its domestic currency by first increasing its supply, before using it to stockhold quantities of a foreign currency. Through making exports more desirable, the

[29] Sager and Taylor, "Under the microscope" [2006] International Journal of Finance and Economics 11, 82.
[30] Zaky, "Forex Market Participants and Why They Trade Currencies" (2016), Fxdailyreport.com, Education.
[31] Zaky, "Forex Market Participants and Why They Trade Currencies" (2016), Fxdailyreport.com, Education.
[32] Markham, "Regulating the Moneychangers" (2016) 18 University of Pennsylvania Journal of Business Law 789, 808.
[33] Forextraders, "Forex Market Participants" (6 November 2016) available at: https://www.forextraders.com/forex-education/forex-fundamental-analysis/forex-market-participants/ [Accessed 31 May 2017].
[34] Investopedia, "Market Participants" available at: http://www.investopedia.com/walkthrough/forex/beginner/level2/market-participants.aspx [Accessed 31 May 2017].

resultant effect will be a weakening of its domestic value.[35] Alternatively, were it to sell its foreign currency reserves in order to buy up quantities of its own currency, the consequential diminution in supply of the foreign currency will culminate in the maintenance of its value.[36] These types of intervention by central banks are commonly referred to as "FX market interventionism".

The third type mentioned within the Code's exhaustive list of FX market participants are brokers. By pinpointing the most competitive buying and selling prices for specific currency pairings,[37] brokers act as intermediaries for exchanges of commodities, equities or foreign currencies. Whilst the brokerage industry is currently in a state of "electrolisation", with some in the City of London said to have "written off traditional voice-broking … [given a recent upsurge in] electronic trading",[38] the aggregate popularity of brokers is ever increasing.

Another significant participant in FX is asset managers. Generally tasked with "currency trading for large accounts like endowments and pension funds",[39] their customers expect portfolio growth following successful engagement with the FX market, amongst others. A similar expectation is made of hedge fund managers, whose licence to invest in FX is often of a volume that can overwhelm even the monetary intervention of a central bank.[40] Also falling within the Code's itemisation of "asset managers" are sovereign wealth funds. Operating on the buy-side of the FX market, these funds are pools of "domestic assets owned and managed by governments to achieve a variety of economic and financial objectives—including the accumulation and management of reserve assets, the stabilisation of macroeconomic effects and the transfer of wealth across

35 Zaky, "Forex Market Participants and Why They Trade Currencies" (2016), Fxdailyreport.com, Education.

36 Info All Search, "Market Participants in Foreign Exchange Markets" (Trading, 2011) available at: http://infoallsearch.blogspot.co.uk/2013/02/main-participants-in-foreign-exchange.html [Accessed 17 January 2017].

37 Forextraders, "Forex Market Participants" (2016), Fxdailyreport.com, Education.

38 S. English, "Year of shocks leads to mega payouts for TP Icap brokers" (6 January 2017), Evening Standard available at: http://www.standard.co.uk/business/year-of-shocks-leads-to-mega-payouts-for-tp-icap-brokers-a3434341.html [Accessed 17 January 2017].

39 Zaky, "Forex Market Participants and Why They Trade Currencies" (2016), Fxdailyreport.com, Education.

40 CurrencyExchangeMarket, "Currency Exchange Market Participants" available at: http://www.currencyexchangemarket.net/role-currency-exchange-market-participants.html [Accessed 31 May 2017].

generations".[41]

The Code also lists persons which, whilst engaged in foreign currency exchanges, would not be considered participants under the Code. The general retail public are an exemplar of this. Whilst the man on the Clapham omnibus looking to obtain three hundred Czech koruna for a stag weekend in Prague is, prima facie, engaging in a foreign currency exchange, his lay status is such that he will not succumb to the rigours of the Code. The same applies for money changers, presumably given that the FX transactions to which they are party involve a retail customer at the other end.

Future of the foreign exchange market

Whilst the FX Code applies to industry players included in its list of "market participants", it is crucial to remember that the Code fundamentally relies upon the existence of a flourishing FX market to which its guidelines can apply. It is notable, however, that FX market activity levels have plateaued since their heyday in 2014, during which volumes often reached $6 trillion per day.[42] Propelled by "tighter bank regulation, the fading emerging market boom and [most pertinently] a secular slowdown in world growth and trade",[43] participants are increasingly being shut-out by "governments attempting to keep their domestic currencies weak in an attempt to export their way out of slow growth".[44] Whilst this state interventionism might result in the artificial stimulation of cross-border trade, there are concerns emerging from the City of London that policy decisions such as these may affect the vitality of FX. Moreover, at a transactional level, unlawful engagement with the market has recently been occurring, by way of rigging and misconduct risk, to be explored below.

[41] F. Bassan, The Law of Sovereign Wealth Funds, 1st edn (Cheltenham: Edward Elgar, 2011), p.18.
[42] A. Nag and J. McGeever, "Foreign exchange, the world's biggest market, is shrinking" (11 February 2016), Reuters, Business News available at: http://www.reuters.com/article/us-global-fx-peaktrading-idUSKCN0VK1UD [Accessed 31 May 2017].
[43] Nag and McGeever, "Foreign exchange, the world's biggest market, is shrinking" (2016), Reuters, Business News.
[44] V. Cignarella, "The Foreign-Exchange Traders' Lament" (24 April 2012), The Wall Street Journal available at: http://blogs.wsj.com/marketbeat/2012/04/24/the-foreign-exchange-traders-lament/ [Accessed 31 May 2017].

Foreign exchange scandals

The past few years have seen the emergence of "ethical drift"[45] in the FX market (as referenced at the beginning of this piece), which has resulted in scandals besetting the industry in the past few years. Amongst other things, these included attempts to "manipulate or control fixes … deliberately triggering client stop loss orders … sharing confidential information with clients and traders at other firms"[46] and also a practice known as "last look"—wherein a trader vetoed a client's request to transact at a price that he had previously quoted. The aforementioned scandals will now be explored in turn.

Manipulation of fix rates and benchmarks

A post-mortem of the FX market found that banks engaged in a variety of practices aimed at manipulating fix rates, such as those set by WM/Reuters and the European Central Bank (ECB).[47] For instance, "traders in a chatroom with net orders in the opposite direction to the desired movement at the fix sought to transact before the fix with traders outside the chatroom".[48] As a result, "[t]his maintained the volume of orders in the desired direction held by traders in the chat room",[49] which in turn led to the avoidance of orders "being transacted in the opposite direction at the fix".[50] Additionally, traders operating in the same chat room "with net orders in the same direction as the desired rate movement at the fix sought before the fix to … Net off these orders

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[45] Bank of England, "Rebuilding Trust through the 'FX Global Code': Reasons for optimism", Speech given by Chris Salmon, ACI UK Square Mile Debate (London: 21 September 2016), p.2 available at: http://www.bankofengland.co.uk/publications/Documents/speeches/2016/speech924.pdf [Accessed 7 July 2017].
[46] Financial Conduct Authority, "Conduct Risk in FX markets", Speech by Edwin Schooling Latter, Head of Markets Policy (2016).
[47] Markham, "Regulating the Moneychangers" (2016) 18 University of Pennsylvania Journal of Business Law 789, 824.
[48] Claer Barrett and John Aglionby, "Traders' forex chatroom banters exposed" (12 November 2014) available at: https://www.ft.com/content/47c32ec4-6a34-11e4-8fca-00144feabdc0?mhq5j=e3 [Accessed 7 July 2017].
[49] Bank of England, Bank of England Foreign Exchange Market Investigation: A Report by Lord Grabiner QC (2014), p.11 available at: http://www.bankofengland.co.uk/publications/Documents/news/2014/grabiner.pdf [Accessed 7 July 2017].
[50] Bank of England, Bank of England Foreign Exchange Market Investigation: A Report by Lord Grabiner QC (2014), p.11.

with third parties outside the chat room, thereby reducing the volume of orders held by third parties that might otherwise be transacted at the fix in the opposite direction".[51]

This was colloquially referred to by those within chatrooms as "'clearing the decks' or 'taking out the filth'".[52] Another rigging practice was the so called "giving you the ammo".[53] This involved the transfer of positions "to a single trader in the chat room, thereby consolidating orders in the hands of one trader".[54] As a result, traders were essentially able to "affect market prices by submitting a rush of orders during the window when the fix is set".[55] This elucidates the cultural failings and deficiencies at the concerned financial organisations.

Triggering client stop-loss orders

Clients have been known to place what are known as "stop-loss" orders with trading firms, in a bid to manage their foreign exchange exposure, by "stipulating the precise details of the order such as price, amount and duration, quantifying the maximum loss on any FX position or strategy in the market".[56] In accepting these orders, "the [trading] firm agrees to transact with the client at or around a specified rate"[57] —provided the currency does in fact trade at that specific rate on the open market.[58] An agreement is contingent upon the "triggering" of the agreed rate—i.e. "when

[51] Financial Conduct Authority, "Final Notice to Barclays Bank Plc" (20 May 2015), p.20 available at: https://www.fca.org.uk/publication/final-notices/barclays-bank-plc-may-15.pdf [Accessed 7 July 2017].
[52] M. Dakers, "How the forex trading scandal came to light" (13 November 2014) available at: http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/11227006/How-the-forex-trading-scandal-came-to-light.html [Accessed 7 July 2017].
[53] M. Levine, "Banks Manipulated Foreign Exchange in Ways You Can't Teach" (12 November 2014), Bloomberg available at: https://www.bloomberg.com/view/articles/2014-11-12/banks-manipulated-foreign-exchange-in-ways-you-can-t-teach [Accessed 7 July 2017].
[54] Bank of England, Bank of England Foreign Exchange Market Investigation: A Report by Lord Grabiner QC (2014), p.11
[55] S. Chrispin, "Forex scandal: How to rig the market" (20 May 2015), BBC News available at: http://www.bbc.co.uk/news/business-26526905 [Accessed 7 July 2017]
[56] P. Golden, "FX: Brexit volatility triggers warnings on stop-loss orders" (16 June 2016), Euromoney available at: https://www.euromoney.com/article/b12kp9wj6t6bq6/fx-brexit-volatility-triggers-warnings-on-stop-loss-orders [Accessed 7 July 2017].
[57] Financial Conduct Authority, "Final Notice to Barclays Bank Plc" (2015), p.9.
[58] Financial Conduct Authority, "Final Notice to Barclays Bank Plc" (2015), p.9.

the currency trades at that rate in the market".[59] Subsequently, this can result in a profit for the relevant trading outfit, for instance, "if the average rate at which the firm buys the currency in the market is lower than the rate at which it sells the currency to the client pursuant to the stop loss order".[60] Furthermore, firms have been found to "manipulate the spot FX rate in order to execute stop loss orders for the firm's benefit and to the potential detriment of its client".[61] By way of example, a firm may transact in a bid to manipulate the spot rate, thus triggering the client's order at the specified rate.[62] This would result in the firm raking in an exponential profit, leaving the client financially worse off.

"Last look"

Another area of manipulation was the practice known as "last look", originally devised to protect banks from being bound to trade at what had become a historic price in fast-moving markets. This practice pertains to trading firms "advertising a price, but reserving the right, when a client asks to trade at that price, to reject the client's order".[63] This is also beneficial for the wider market, both in terms of price discovery and also in terms of accurate valuation for those who intend not to trade. It is for this reason that there are regulatory requirements in place in other financial markets, which stipulate that "prices advertised through the systems of a trading venue to be firm—ie executable—and pre-trade transparent".[64] The abuse of the last-look practice in the FX spot market was an area of concern for regulators. Here, trading firms were found to have been asymmetrically[65] refused orders deemed unprofitable after advertising a set price. For instance,

[59] Financial Conduct Authority, "Final Notice to Barclays Bank Plc" (2015), p.9.
[60] Financial Conduct Authority, "Final Notice to UBS AG" (November 2014), p.9 available at: https://www.fca.org.uk/publication/final-notices/final-notice-ubs.pdf [Accessed 10 July 2017].
[61] Financial Conduct Authority, "Final Notice to CITI Bank" (November 2014), p.9 available at: https://www.fca.org.uk/publication/final-notices/final-notice-citi-bank.pdf [Accessed 10 July 2017].
[62] Financial Conduct Authority, "Final Notice to UBS AG" (2014), p.9.
[63] Financial Conduct Authority, "Conduct risk in FX markets", Speech by Edwin Schooling Latter, Head of Markets Policy (2016).
[64] Financial Conduct Authority, "Conduct risk in FX markets", Speech by Edwin Schooling Latter, Head of Markets Policy (2016).
[65] HM Treasury, Bank of England and Financial Conduct Authority, Fair and Efficient Markets Review: Final Report (June 2015), p.31 available at: http://www.bankofengland.co.uk/markets/Documents/femrjun15.pdf [Accessed 31 May 2017].

Barclays Bank was fined a hefty $150 million for rejecting transactions without explaining to clients who executed orders at the advertised price.[66] In the words of the New York State Department for Financial Services: "instead of employing Last Look as a purely defensive measure, Barclays instead used it as a general filter to reject customer orders that Barclays predicted, based on price movements during the hold period, would be unprofitable to the Bank".[67]

In sum, practices such as the aforementioned seemingly fractured trust at the helm of the FX market, thus leading to the emergence of the Code.

Birth and development of the Code

As expressed above, scandalous activities in the FX market of late have hastened calls for appropriate regulatory responses. Since the third G20 Summit in September 2009, a plethora of these have come to pass—including the European Market Infrastructure Regulation (EMIR)[68] and the Dodd-Frank Act 2010,[69] put forward to increase transparency in the derivatives market. However, without a normative substrate of "behavio[u]rs, practices, values & ethics"[70] by which market participants are unified, the effectiveness of standalone statutory instruments and regulations is hugely inhibited. This lacuna in turn provided the rationale for the Code—a rationale which nestles snugly alongside global attempts at networked governance, such as the Financial Stability Board's ongoing review of financial market benchmarks and subsequent attempts at reform.[71]

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[66] New York State Department for Financial Services, "NYDFS announces Barclays to pay additional $150 million penalty, terminate employee for automated, electronic foreign exchange trading misconduct" (November 2015) available at: http://www.dfs.ny.gov/about/press/pr1511181.htm [Accessed 7 July 2017].

[67] New York State Department for Financial Services, "NYDFS announces Barclays to pay additional $150 million penalty, terminate employee for automated, electronic foreign exchange trading misconduct" (2015).

[68] Regulation 648/2012 on OTC derivatives, central counterparties and trade repositories [2012] OJ L201/1.

[69] Dodd-Frank Wall Street Reform and Consumer Protection Act 2010.

[70] V. Dimase, "FX Global Code of Conduct: keeping the wolf out of the door" (19 July 2016), LinkedIn available at: https://www.linkedin.com/pulse/fx-global-code-conduct-keeping-wolf-out-door-vincenzo-dimase [Accessed 31 May 2017].

[71] Financial Stability Board, Foreign Exchange Benchmarks: Final Report (30 September 2014) available at: http://www.fsb.org/wp-content/uploads/r_140930.pdf [Accessed 31 May 2017].

Code development groups

Originally announced by the Bank of International Settlements in mid-2015, the Code is set to be the product of a two-year collaboration between the public and private sectors,[72] featuring contributions from central banks, and equally from Investment Management outfits and Banks. Central bank involvement comes in the form of the FXWG. Chaired by the Deputy Governor of the Reserve Bank of Australia, Guy Debelle, the group draws on the expertise of leading players in central banks including those of Australia, China, France, India, England and New York's Federal Reserve, amongst others.[73] In doing so, the FXWG aims to "facilitate the creation of the Global Code and to promote its adoption",[74] thus indirectly encouraging the Financial Stability Board's efforts at "cleaning-up" the FX industry.[75]

Investment management and bank involvement in drafting the Code is made via the Market Participants Group (MPG), a unit "drawing on participants from the sell side and buy side of the market as well as FX infrastructure providers"[76] —from Rolls-Royce and BlackRock to Deutsche Bank and JP Morgan. Chaired by David Puth, CEO of cash settlement system provider CLS, the MPG serves a double function; it provides substantive guidance on the drafting of the Code but also serves as a hub through which MPG members can filter relevant information gleaned first, from within their particular institution and secondly, from their nation's FX committee (FXC).[77]

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[72] Bank of England, "Rebuilding Trust through the 'FX Global Code'" (2016), p.2.
[73] Bank for International Settlements, Foreign Exchange Working Group (Markets Committee, 13 September 2016) available at: http://www.bis.org/about/factmktc/fxwg.htm [Accessed 31 May 2017].
[74] Bank for International Settlements, FX Global Code: May 2016 Update (2016), p.2.
[75] Bank for International Settlements, Foreign Exchange Working Group (2016).
[76] Bank for International Settlements, Working group to strengthen code of conduct standards and principles in foreign exchange markets has commenced work (2015).
[77] Bank for International Settlements, Foreign Exchange Working Group (2016).

Phases of development

As far as work on the Code goes, the task had been delineated into two phases. The first of these elapsed in May 2016. Led by the Federal Reserve Bank of New York's Head of Markets, Simon Potter, and with input from both the FXWG and the MPG, the first phase has brought together "common elements of the existing FX codes as well as drafting new principles for those areas not adequately covered in existing codes"[78]; existing FX codes which include those pioneered by the FXCs in Hong Kong, London and New York, amongst others.[79] In sum, therefore, the first phase oversaw substantive draftsmanship of the Code. The second phase concluded in May 2017 and had a comparatively varied raison d'être, serving the following four functions.

First, Phase 2 involved finding mechanisms which "promote and incentivise adherence"[80] to the Code, which are outlined within an ancillary report.[81] This report makes clear that market participants and central banks should lead the charge in the term of adherence, by setting out their intentions to adhere to the Code and placing an expectation on their regular trading counterparts that they do the same.[82] Secondly, Phase 2 addressed FX practices that the *2015 Fair and Effective Markets Review*[83] deemed worthy of reform. By way of example, one such practice was that of "last-look" retraction—as referred to extensively in the previous section, above. As "last look" is often perceived as being onerous to the client, some financial markets have provisions in place which oblige traders to operate transparently throughout the life of a trade.[84] As a result, the FXWG and

[78] Bank for International Settlements, Working group to strengthen code of conduct standards and principles in foreign exchange markets has commenced work (2015).
[79] Bank of England, "Codes of Best Market Practice and Shared Global Principles" available at: http://www.bankofengland.co.uk/markets/Documents/forex/fxjsc/codes.pdf [Accessed 29 January 2017].
[80] Bank for International Settlements, Working group to strengthen code of conduct standards and principles in foreign exchange markets has commenced work (2015).
[81] Bank for International Settlements, Foreign Exchange Working Group: Report on Adherence to the FX Global Code (May 2017) available at: http://www.bis.org/mktc/fxwg/adherence_report.pdf [Accessed 26 May 2017].
[82] Bank for International Settlements, Foreign Exchange Working Group: Report on Adherence to the FX Global Code (2017), p.2.
[83] HM Treasury, Bank of England and Financial Conduct Authority, Fair and Efficient Markets Review: Final Report (2015).
[84] HM Treasury, Bank of England and Financial Conduct Authority, Fair and Efficient Markets Review: Final Report (2015), p.30.

MPG imported a similar obligation into the Code under Execution Principle 17.[85] Thirdly, Phase 2 entailed substantive completion of the Code's Governance section and also its Risk Management and Compliance section, which were previously stated to be "in development"[86] as per the Phase 1 update released in May 2016. Finally, Phase 2 looked into electronic execution practices on FX trades,[87] inviting suggestions as to how market participants operating FX e-trading platforms should conduct themselves.[88]

Overview of the Code

As explained above, the Code is a laudable public–private partnership in transnational economic governance. It provides a "common set of guidelines to promote the integrity and proper functioning of the wholesale [FX] market".[89] It also adopts a principles-based approach to governance and "does not impose legal or regulatory obligations on Market Participants nor does it substitute domestic regulation".[90] The primary intent appears for it to be an essential reference for market participants and regulators, and will herein be examined on three grounds: its content, its negotiation and its implementation.

Substantively, the Code appears to have been drafted on the basis of six broad-brush principles: ethics, governance, information sharing, execution, risk management and compliance, and confirmation and settlement processes. The Code's breadth is then mitigated by more detailed guidance on each of the broad principles outlined above, thus revealing a trade-off between transferability and specificity. The Code is also accompanied by an annex containing examples "intended to help illustrate concepts drawn from the principles".[91] This setup is not entirely

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[85] GFXC, FX Global Code (2017), p.20.
[86] Bank for International Settlements, FX Global Code: May 2016 Update (2016), pp.8 and 20.
[87] Kulkin, Green and Mills, "FX Global Code of Conduct May Raise Compliance, Disclosure Issues for Market Participants" (2016), Lexology.
[88] GFXC, FX Global Code (2017), p.14.
[89] Bank for International Settlements, FX Global Code: May 2016 Update (2016), p.2.
[90] Bank for International Settlements, FX Global Code: May 2016 Update (2016), p.2.
[91] Bank for International Settlements, FX Global Code: May 2016 Update (2016), p.27.

surprising given the diversity of participants in the FX market, as explained above. Thus, a set of specific "cafeteria" style principles would have risked a "one size fits all", meaning that the principles may lose their utility when applied in disparate settings. The core elements of responsibility and accountability permeate the Code. These appear to want participants to strengthen their internal practices, thus increasing compliance and good behaviour in the wholesale FX market—corresponding with Iris Chiu's seminal idea of regulating from the inside.[92] At the heart of the Code is a requirement for market participants to adhere to the highest standards of ethics and to act with honesty, fairness and integrity when dealing with clients and other market actors.[93] Participants are also required to put in place sound and effective governance frameworks "to provide for clear responsibility and comprehensive oversight of their FX Market activity".[94] Except in limited circumstances, market participants are advised to refrain from disclosing confidential information and to communicate in a manner that is clear, accurate, professional and not misleading.[95] This may mean an end to coarse and irreverent language in exclusive chat rooms. The aspects of the Code on execution are also welcome. Market participants are expected to exercise care when negotiating and executing transactions in order to promote a "robust, fair, open, liquid and appropriately transparent FX market".[96] There is also a requirement for participants to improve their risk management practices and to put in place appropriate compliance and review systems to mitigate and manage the risks that may arise from a market participant's activities in the FX market. The Code, however, makes clear that these systems may vary in scope and complexity given the disparate nature of participants in the wholesale FX market.[97] The ideals of responsibility and accountability also permeate the principles on confirmation and settlement. Market participants are expected to put in place efficient, transparent, risk-mitigating post-trade

[92] I. Chiu, The Regulating (from) the Inside: The Legal Framework for Internal Control in Banks and Financial Institutions, 1st edn (London: Bloomsbury, 2015), p.4.
[93] GFXC, FX Global Code (2017), p.6.
[94] GFXC, FX Global Code (2017), p.9.
[95] GFXC, FX Global Code (2017), p.23.
[96] GFXC, FX Global Code (2017), p.12.
[97] GFXC, FX Global Code (2017), p.28.

processes in order to promote the predictable, smooth and timely settlement of transactions in the FX market.[98] Doing so does justice to the importance of a liquid and functional FX market, and mitigates the disruptions to trade settlement that illiquid FX markets might have for the real economy. In general, therefore, the Code represents a welcome development in transnational economic governance. It is now important to investigate its drafting and negotiation and the strategies put forward for its implementation.

Drafting and negotiation

As described above, the drafting and negotiation of the Code involved the public–private partnership of regulators and market participants. Whilst this approach is laudable, it does not mask lacunas nonetheless present within the drafting and negotiation process. First, there are significant concerns about the diversity of market participants and regulators involved in the drafting process. It appears that the market participant list was inordinately made up of the largest asset managers and banks, but market actors like sovereign wealth funds and pension funds (who operate on the buy side of the market) are conspicuously absent. There are also concerns about emerging market representation on the market participants list. The only emerging market participants appear to be representatives of large commercial institutions from China, Hong Kong and India. Chilean, Malaysian, Nigerian and Russian financial institutions are notably omitted, even though these countries are classed as emerging markets and also have properly functioning FX markets, as too is South Africa.[99] Secondly, the regulators who negotiated the Code appear to have originated mostly from developed markets. In fact, the only emerging market regulatory representatives were the Chinese State Administration of Foreign Exchange (SAFE), the Reserve Bank of India, the Mexican Central Bank and its Brazilian counterpart. The Foreign Exchange *sub-*

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[98] GFXC, FX Global Code (2017), p.41.
[99] D. Mminele, "Note on the foreign exchange market operations of the South African Reserve Bank", BIS Papers No.73 available at: http://www.bis.org/publ/bppdf/bispap73x.pdf [Accessed 31 May 2017].

committee of the South African Reserve Bank appears to have been included, belatedly, during the formation of the new Global Foreign Exchange Committee (GFXC) which now oversees the Code.[100] Also omitted was the Bahraini Central Bank, despite it overseeing the largest FX market in the Middle East.[101] This calls into question the "global" character of the Code and raises significant issues of input legitimacy. A corollary of this might thus be fragmentation of the Code or its rejection in key emerging markets.

Implementation

On the question of implementation, the litmus test for the Code lies in how market actors will integrate it into their practices. Its non-prescriptive nature means that it does not impose legal or regulatory obligations on market participants. Compliance thus depends on the goodwill of market actors. For this reason, the FXWG has put forward certain measures to demonstrate commitment to the Code. These include the incorporation of the Code as a prerequisite for membership of private FX committees, the adoption of the Code as part of the admission process into financial markets infrastructures (such as electronic trading platforms and settlement systems) and a statement of commitment to be signed by market participants upon adherence to the code.[102] Other suggestions include the incorporation of elements of the Code into domestic regulatory structures such as the UK's Senior Managers and Certification Regime.[103] These integrity measures have their merit but also carry considerable risks.

For one, the inclusion of the Code in the membership procedures of FXCs represents a less

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[100] GFXC, "Membership" (May 2017) available at: http://www.globalfxc.org/membership.htm?m=61%7C370 [Accessed 31 May 2017].
[101] J. Gaspar, J. Kolari et al, Introduction to Global Business: Understanding the International Environment, 2nd edn (Mason: South-Western College Publications, 2016), p.97.
[102] Bank for International Settlements, Foreign Exchange Working Group; Report on Adherence to the FX Global Code (2017).
[103] Bank For International Settlements, "The Global Code of Conduct for the Foreign Exchange Market", Speech given by Guy Debelle, CLS FX Industry Reception (Sydney: 30 January 2017), p.3 available at: http://www.bis.org/review/r170201a.htm [Accessed 31 May 2017]. See also Bank of England, "Rebuilding Trust through the 'FX Global Code'" (2016), p.4.

adversarial approach to monitoring as opposed to top–down monitoring from public regulators. It enables FXCs to serve as gatekeepers in their various jurisdictions, keep the Code under review and develop strong lines of responsibility amongst members. There is, however, some circumspection about this approach. It seems likely that leaving the task of monitoring the Code to private actor-dominated FXCs might be perceived as unduly light-touch in approach. Former codes negotiated and agreed by FXCs tended to be voluntary and, in most cases, required remediation of a breach before the issue could be escalated to the FXC secretariat. By way of example, for counterparties who suspected an infraction of the UK's 2011 Foreign Exchange Joint Standing Committee (FXJSC) Code, remedial action was only available with the trading partner, with issues of interpretation referable only to the FXJSC secretariat.[104] Similarly, the 2012 Code of Conduct drafted and agreed by the Singapore Foreign Exchange Market Committee (SFEMC) urges market participants who suspect a breach of the Code to settle with the offending counterparty and to refer the matter to the secretariat of the SFEMC if no settlement is reached.[105] The same goes for the ACI Model Code where actors are required to go for an amicable settlement of any breach before escalating the matter to the ACI Committee for Professionalism.[106] The danger of a remediation approach is that it fails to cater for situations where market parties may be engaging in collusive misconduct—a practice starkly elucidated by the FX misconduct scandal. If the Code is to be monitored by FXCs, then individual committees must devise stronger enforcement strategies, on the basis that former codes seemingly had no robust record of enforcement. Appropriate strategies might include higher reporting of compliance to the FXC secretariat and tougher sanctions, including the escalation of serious cases to the appropriate

[104] FXJSC, "The Non-Investment Products Code For Principals and Broking Firms in the Wholesale Markets" (2011), p.4 available at: http://www.bankofengland.co.uk/markets/Documents/forex/fxjsc/nipscode1111.pdf [Accessed 31 May 2017].

[105] SFEMC, The Singapore Guide to Conduct & Market Practices for Treasury Activities (April 2012), p.18 available at: http://www.sfemc.org/pdf/SingaporeBlueBook_April2012.pdf [Accessed 31 May 2017].

[106] ACI, The International Code of Conduct & Practice for the Financial Markets Association: The Model Code (February 2015), p.60 available at: http://www.aciforex.co.za/2014/wp-content/uploads/2015/02/the_model_code_february_2015.pdf [Accessed 31 May 2017].

regulator, pecuniary sanctions and, in extreme cases, the withdrawal of membership. Another option put forward by the FXWG is the adoption of the Code as a prerequisite for admission on financial market infrastructures, such as trading venues and settlement systems.[107] This is not without precedent. Market infrastructure providers like the London Stock Exchange (LSE) already publish rules which corporations must adhere to if they are to be admitted or listed on exchange platforms and trading venues.[108] These standards are backed by robust sanctions including fines and suspensions from the facility.[109] Given that market infrastructure providers have been co-opted into the drafting and negotiation process, incorporating the Code into their membership criteria would be seamless. The difficulty, however, lies in the policing aspect. Many of these infrastructure providers profit from the execution and settlement of trades of their platforms. In fact, the biggest FX market players are shareholders of CLS international.[110] This could erect strong conflicts of interest and lead to weak enforcement, thus damaging the utility of the Code.

The FXWG has also developed a readily accessible Statement of Commitment,[111] which market participants can use to publicly demonstrate commitment to the Code and to support key objectives of the Code, such as enhancing transparency, efficiency and functioning in the FX market. The FXWG believes that the public use of this document will generate a network effect and thus promote compliance.[112] To strengthen this attestation system, the MPG of the FXWG is developing public registers where firms can demonstrate their use of the aforementioned Statement of Commitment.[113] Work on this register is still in development with a number of

[107] Bank for International Settlements, Foreign Exchange Working Group; Report on Adherence to the FX Global Code (2017), p.3.
[108] London Stock Exchange, Admission and Disclosure Standards (effective 8 May 2017) available at: http://www.londonstockexchange.com/companies-and-advisors/main-market/documents/admission-and-disclosure-standards.pdf [Accessed 31 May 2017].
[109] London Stock Exchange, Admission and Disclosure Standards (2017), pp.25 and 27.
[110] CLS International, "Shareholders" (2017) available at: https://www.cls-group.com/About/Pages/Shareholders.aspx [Accessed 31 May 2017].
[111] Global Foreign Exchange Committee, "Statement of Commitment to the Global FX Code" (May 2017) available at: http://www.globalfxc.org/docs/statement_of_commitment.pdf [Accessed 31 May 2017].
[112] Bank for International Settlements, "The FX Global Code—defining the next steps towards a standard industry Code of Conduct", Speech given by Guy Debelle, TradeTech FX Asia Conference (Singapore: 22 March 2017), p.4 available at: http://www.bis.org/review/r170322e.pdf [Accessed 31 May 2017].
[113] Global Foreign Exchange Committee, "Statement of Commitment to the Global FX Code" (2017).

possible options under consideration, including the establishment of a link between registers for ease of reference by interested parties, such as prospective counterparties and clients.[114]

Another monitoring system under consideration, especially in the domestic regulatory arena, is the incorporation of elements of the Code into regulatory structures like the UK's Senior Managers and Certification Regime.[115] This will undoubtedly provide a binding effect by holding relevant authorised persons such as senior managers responsible for future FX misconduct, but it is not without its perils. It may also stifle experimentation and novel techniques in what is an otherwise roving and dynamic market, and also risk holding senior managers to account for the actions of traders who may have been acting on their own accord. Furthermore, the adoption of the Code in domestic regulatory frameworks may produce a paradoxical effect—a regulatory race to the bottom where certain jurisdictions lower the application of the Code or neuter it in the competition for market share. This in turn could lead to the unravelling of the Code and possible fragmentation. Note, in particular, the decision of Chinese regulators to explore the possibility of a "Chinese" version of the Code for local and foreign banks operating in the Chinese onshore market.[116] A diminution of the Code to suit Chinese banks and FX operators may lead to greater regulatory arbitrage, in which trading firms capitalise on such low standards in a bid to circumvent the more robust domestic frameworks of other FX markets.

On the basis that the Code is now complete and has been unveiled, the focus will rightly move to how market participants embed it into their institutional practices. Whilst it provides practical guidance on ethics, information sharing, governance, risk management, execution and settlement,

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[114] Bank for International Settlements, Foreign Exchange Working Group: Report on Adherence to the FX Global Code (2017), p.4.

[115] Bank for International Settlements, "The Global Code of Conduct for the Foreign Exchange Market", Speech given by Guy Debelle, CLS FX Industry Reception (2017), p.3. See also Bank of England, "Rebuilding Trust through the 'FX Global Code'", Speech given by Chris Salmon, ACI UK Square Mile Debate (London: 21 September 2016), p.4 available at: http://www.bankofengland.co.uk/publications/Documents/speeches/2016/speech924.pdf [Accessed 31 May 2017].

[116] A. Aimone, "China to create own version of FX code" (11 August 2016), FX Week available at: http://www.fxweek.com/fx-week/news/2467548/china-to-create-own-version-of-fx-code [Accessed 31 May 2017].

the Code's litmus test will thus be the ability of market participants and regulators to demonstrate their commitment to it, through robust implementation and monitoring.

Concluding remarks

The Code looks set to be the first step in a much-needed clean-up project of the financial markets, providing the catalyst for a new wave of cross-border economic governance in the process. Whilst this overarching aim is clear, what remains to be seen is whether concerns about the diversity of market participants involved in the drafting process, and also concerns about implementation and adherence, will scupper attempts to achieve its aim. Ultimately, this will only fully become clear once the dust raised by the Code's unveiling has settled.