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Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC.

Global Risk Watch Newsletter

The Creeping Shadow of Global Discord, etc.

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Commitment to code of conduct: the FX Global Code (Shiro Katsufuji, Director, Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC)

Preparation are proceeding at an accelerated pace for the signing on Statement of Commitment for the FX Global Code (FXGC). The FXGC is a set of global principles finalized in May 2017 that the Foreign Exchange Working Group (FXWG) has developed in partnership with central banks and market participants from 16 jurisdictions. The FXGC consists of six leading principles, Ethics, Governance, Execution, Information Sharing, Risk Management and Compliance, and Confirmation and Settlement Processes, followed by 55 principles. They elaborate on the ethical standards required of market participants, the facilitation of a governance regime, and other matters necessary in order to promote a robust, fair, liquid, and appropriately transparent foreign exchange (FX) markets and their transaction execution.

With commitment from respective central banks, market participants are expected to comply with the FXGC by way of FX market committees in each country promoting said Code. The committees from 8 jurisdictions have already declared their commitment to its implementation. In Japan, the Tokyo Foreign Exchange Market Committee is in charge of spearheading adherence to the Code, and the market participants are expected to announce their commitment by signing the Statement and publishing it. It is anticipated that it will take 6 to 12 months for market participants to prepare for compliance with the Code.

There are several points can be made concerning the promotion of adherence to the FXGC. First, the FXGC is a voluntary code, rather than binding regulation, for which market participants facilitate their own compliance regime

and announce their commitment. This means that, while the Code does not have legal authority, it requires market participants to develop specific targets in order to realize fair FX markets. Given the fact that the FX market is composed of market participants themselves, and promotion of the FXGC is based upon the commitment of central banks, adherence to the Code is a practical prerequisite for those willing to participate in smooth FX transactions in the wholesale market.

Second, the FXGC targets not only the sell side (i.e. banks and securities firms), but also the buy side (i.e. trust funds, insurance firms, and other non-financial corporations). Since the FX market consists of a wide range of participants from both sell and buy sides, compliance by all of these players was deemed necessary to ensure fair market environment. Hence, the expectation is also high for the buy-side participants to prepare for compliance and declare their commitment.

Third, the FXGC provides guidance on daily, transaction-related activities including pre-hedge, stop loss order, and handling of confidential information, and requires their monitoring. In the FX market, a tremendous number of transactions are executed in a second via voice brokers, electronic transaction systems, and other financial transaction communication channels. Proper monitoring of these transactions requires a commensurate structure. The examples include a monitoring team to control dealers, processes to organize and investigate transaction communication records and escalate any issues, relevant trainings, and IT infrastructure to enable an automatic monitoring system for all of the above. Certain financial institutions with advanced conduct risk monitoring regime are facilitating systems for front office supervision and surveillance for not only FX trades, but also derivatives and securities.

Fourth, to prevent misconduct, a code will be necessary for a greater range of market conduct and other markets in addition to the FXGC. In the US, a number of large-scale banks have been charged for enforcement actions due to front running and inappropriate use of confidential information in FX trading. Regardless of the FXGC, these are the cases where misconduct in the FX market was judged as fraud or inadequate risk management in supervision. The fact that FXGC is voluntary does not mean it relaxes regulation on misconduct prevention in the FX market, but rather it calls for reinforced internal control regime to avoid such precedents.

Lastly, when the Code was released last May, the FXWG acknowledged that “most Market Participants will need approximately 6 to 12 months” to adhere to the code. This implies that central banks are anticipating the signature of the Statement of Commitment within approximately 1 year after its release. As this 1-year mark is approaching very soon, market participants need to accelerate their preparation to facilitate their internal structures for early commitment.

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