29 January 2015

**Fair and Effective Markets Review (FEMR or "Review")**
**How Fair and Effective are the Fixed Income, Foreign Exchange and Commodities Markets?**

**FIA Europe response**

## *Part I: Introduction*

We attach our response to the questions raised in the joint Bank of England, HM Treasury and Financial Conduct Authority (FCA) review on the fairness and effectiveness of Fixed Income, Foreign Exchange and Commodities markets. In summary:

- **Liquidity**: a well-functioning effective market must be underpinned by sufficient liquidity for there to be consistent observable prices, narrow spreads, and the ability to execute transactions or a series of transactions or strategies. The availability of liquidity stems from the presence of a range of different market participants.
- **Outcome-Based Solutions:** in determining the scope of regulations, regulators should try to achieve outcomes-based solutions.
- **Asymmetry of Information:** there are inherent areas where asymmetry of information occurs and cannot be mitigated, e.g. where producers also trade in financial markets relating to such products.
- **Standardised Code of Conduct:** regular dialogue with the industry in the creation of market codes of conduct and setting expectations of conduct, will aid in fostering a pragmatic and consistent approach to regulation. FIA Europe members encourage the creation of a FICC market wide code of conduct, including a practitioner panel (with the ability to discipline market misconduct). This should go in hand with clear regulatory expectations of appropriate and inappropriate market conduct.
- **Existing Tools:** regulators now have a substantial array of regulatory tools at their disposal to address misbehaviour. Rather than seek to impose more regulation, regulators should seek to use existing tools, and enforce standards consistently.
- **Incoming Regulation:** the industry would also benefit from stability if current and ongoing legislative developments are allowed to embed prior to developing new regulations. Only once MiFID II/R, EMIR, REMIT and the Market Abuse regime have been fully implemented will it be possible to assess the existence of any gaps and the need for further intervention.
- **Global Solutions and Harmonisation:** FICC markets are global markets. Consequently, we advocate a global coordination and harmonisation of regulatory implementation and enforcement.

FIA Europe has not responded to the following FEMR questions: 7, 8, 34, 43, 44, 45, 48 and 49.

***Part II: Answers to Questions***

***What does 'Fair and Effective' mean for FICC markets?***

***Q1: The Review would welcome respondents' views on the definition of 'fair and effective' FICC markets proposed in Section 3. Does it strike the right balance between safeguarding the interests of end-users without unnecessarily impeding the effectiveness of FICC markets? Are the concepts of transparency, openness and equality of opportunity appropriately specified? And how does the definition compare with those used in other markets, jurisdictions, organisations or legislation?***

We broadly support the definition of 'fair and effective' FICC markets. Notwithstanding such support, FICC markets are largely wholesale markets in which retail clients or consumers have little participation. Accordingly, whilst wholesale markets should aspire to be fair and effective, such fairness and effectiveness should not be gauged against the standards established for the retail market.

- We agree with the conclusion in the Consultation Document that there is a sufficient presence of regulation surrounding FICC markets, particularly in light of the recent pace of reform. We support, insofar as is possible, mitigation of the cost and operational impact of regulation, avoidance of double regulation or gold-plating, and the proposal to enforce existing regulation and using existing tools.
- We note that in some circumstances, FICC markets may be 'effective' or 'fair' and that certain situations may require priority to be given to one over the other. Different markets function in different ways. Therefore, different trading mechanisms are needed to support different instruments with different liquidity providers, different users of these markets and how liquidity is preserved in the markets. It is important to strike a balance between liquidity and transparency.

**On the characteristics of 'Effective'**

A major theme underlying the effectiveness of a market is liquidity. A well-functioning market must be underpinned by sufficient liquidity for there to be consistent observable prices, narrow spreads and the ability to execute transactions or a series of transactions or strategies. It should be noted that the availability of liquidity stems from the presence of a range of different market participants. There are concerns that efforts to increase transparency without giving regard to the effects on the markets may remove the incentive for participants to be active in the market, and are feared to have detrimental effects on liquidity. The Review should consider this in the context of considering introducing further regulation and/or other regulatory measurements.

The Review's analysis of liquidity presented in Box 4 on page 21 of the consultation highlights a key misunderstanding of the link between liquidity and price formation. We believe that the Review should prioritise liquidity, as greater liquidity results in markets which are less easily manipulated, and consequently regulators should afford market participants the tools with which to foster liquidity. We do not believe that an 'oversupply' of liquidity can be detrimental to markets, but the supply of liquidity without appropriate risk management can be imprudent.

We ask the Review to clarify their vision of an effective market – do they intend to see a single liquidity pool for all market participants? Or one dealer-to-dealer market, and one dealer-to-participant market? More onerous execution obligations and greater controls around conflicts of interest have seen dealers move to a true agency model.

*Enabling Investment Funding and Risk Transfer Underpinned by Robust Infrastructure*

We broadly support the proposed definition.

*Competitive Prices*

Whilst the definition proposed in relation to ‘competitive price’ is generic and may not adequately reflect the complexities of all FICC markets, we largely agree with the proposal.

However, there are some inconsistencies in the Review’s understanding of pricing which could result in less competitive pricing. Some markets have no observable prices. It therefore becomes increasingly difficult, particularly in illiquid instruments, to determine what constitutes a competitive price. Illiquid instruments traded across platforms could potentially have narrow trading windows that would artificially concentrate liquidity, but could result in participants leaving the market. Certain markets simply do not allow for there to be observable pricing: markets with no observable prices should be exempted from observable prices requirements, whilst respecting the required level of transparency.

**On the characteristics of ‘Fair’**

Like other wholesale markets, FICC markets reflect the application of the *caveat emptor* principle, in that counterparts to commercial transactions are willing participants and no one is forced to accept a price which is offered. The *caveat emptor* principle is tried and tested, however it may be undermined as a consequence of a lack of controls around market participants that are able to act in a dual capacity as agent and principal and therefore have access to asymmetric information. This can lead to the improper application of best execution and fiduciary duties.

We do recognise that not all products and markets are homogenous and therefore regulators should not seek to extend the caveat emptor principle to all markets. Wholesale markets have traditionally been permitted to regulate themselves and indeed have developed mechanisms to address market manipulation. We encourage the Review to continue to allow wholesale markets to set regulation for standards of fair and honest market practices, tailored to the type of market and counterparty (for example, specific rules on dealing with Eligible Counterparties under MiFID II). The possibility for self-regulation should be considered and properly calibrated in order to avoid causing detriment to end-users/consumers.

In some instances liquidity is developed by exchanges putting in place market making incentive schemes and other arrangements with market participants. Such market participants are encouraged to provide liquidity not only through incentives, but also through trading arrangements, to accumulate significant positions in a stock through the provision of liquidity or to suspend trading in disorderly market conditions such that they do not show their hand on every order. This could be deemed unfair, but underpins the good functioning of an effective market.

The Review should consider whether by ‘fair’ they mean something else – ‘not unfair’, ‘unbiased’ or align with existing terminology under MiFID II/R ‘free from abuse’. Indeed, a market which is susceptible to significant abuse is not sustainable and will eventually damage itself.

*Clear Standards of Market Practice*

Whilst we support the presence of clear standards of market practice, market participants would be best served by a mixed approach towards clear standards of market practice.
It is desirable that regulators reduce any uncertainty by providing appropriate guidance and fostering a collaborative environment within which market participants may seek clarifications from the regulator without fear of punishment. One way to achieve this is to establish an institutional whistle blowing procedure.

Principles-based guidance together with sufficiently granular direction on the scope or applicability of the regulations would allow market participants the greatest flexibility as well as legal certainty. It may also be appropriate to set up an industry code of market conduct supported by a Board of industry representatives, to align market practise across FICC markets and give “teeth” to an industry-led corrective mechanism.

Whilst we support the existence of clear standards of market practice, the absence of an established code of conduct should not necessarily imply unfairness.

*Transparency*

We ask that the Review clarify what it understands by the term ‘transparency’ in the context of a fair market. It is unclear as to whether the Review intends for all market participants and end-users to have access to the same information. It is also important to recognise that some FICC markets are not naturally transparent, and do not lend themselves to a ‘price-on-screen’ model which has become common for liquid equities.

Indeed, trying to ‘force’ transparency may be difficult and may not benefit the end consumer or market participants. For example, a trade reporting regime could result in market participants being required to reveal their trading strategies before they have been able to successfully execute the same, which could result in them leaving the market, thereby damaging liquidity and price formation.

Transparency should not be seen in isolation, but should be considered with all its potential consequences. It may not be necessary to achieve full transparency on every aspect of FICC markets, but it is important that the benchmarks which underlie a large number of end-user pricing and valuation mechanisms should be free from manipulation and have robust methodologies. In this regard, it is important to highlight that many of the perceived short-comings in the market were due to an insufficiently robust valuation mechanism (see LIBOR) rather than purely due to a lack of transparency.

*Open ‘Merit-Based’ Access*

The principle of open access should reflect the accessibility by market participants to FICC markets on the basis of non-discriminatory and objective criteria. This should not mean that retail customers should be allowed to access wholesale markets. It is important to note, however, that by forcing market participants to provide non-discriminatory access, in conjunction with a less flexible governance framework, competition could be stifled by dis-incentivising investment in innovation. This should therefore be read as ‘non-discriminatory access enabling competition’.

Regarding open access to clearing, there is a dis-connect between EMIR and CRD IV. EMIR requires mandatory clearing of certain derivatives, via clearing brokers. However, CRD IV is significantly driving up clearing brokers’ costs and, through the leverage ratio, restricts the capacity of clearing brokers to provide a clearing service. Clearing brokers do not therefore have the ability to accept all market participants as clients. Further they should not be required to take credit risk on counterparties of unduly poor credit quality.

*Competition on the Basis of Merit*

It is important to qualify the notion of competition “on the basis of merit”. Whilst we support there being a level playing field for all market participants, many firms which have achieved an ‘incumbent’ status through significant investment in the resources and processes necessary to transact large proportions of business, which has resulted from merit in its own right. For example, firms in some cases have built up the technology and capacity to be able to meet client demand for securities through internalisation have done so at significant cost and are able to offer clients best execution by offering tighter bid-offer spreads and lower fees.

*Integrity*

We agree that FICC markets should operate with integrity.

**A framework for evaluating fairness and effectiveness**

***Q2: Of the six themes identified in Table A on page 5 (market microstructure; competition and market discipline; benchmarks; standards of market practice; responsibilities and incentives; and surveillance and penalties), which do you consider to be the most important factors contributing to the recent series of FICC market abuses? In which other areas do you believe the fairness and effectiveness of FICC markets globally may be deficient? Do these answers vary across jurisdictions, or specific markets within FICC? Are there any other important areas of vulnerability that are not identified in the table?***

Themes identified in Table A, being market microstructure, competition and market discipline, benchmarks, standards of market practice, responsibilities and incentives, and surveillance and penalties, are fairly broad and equally and adequately address the factors contributing to FICC market abuses.

We cannot identify any other important areas of vulnerability that are not identified in the table, nor are we able to point to specific jurisdictional or market-specific deficiencies.

We therefore do not see any scope for inclusion of other areas of vulnerabilities.

***Barrier and digital options***

***Q3: Do trading practices involving barrier or digital options pose risks to the fairness and effectiveness of one or more FICC markets? How hard is it to distinguish between hedging and 'defending' such options in practice? Should further measures be taken to deal with the risks posed by barrier options, whether through market-wide disclosure of significant barrier positions, an extension of regulation or some other route?***

As with many other financial instruments, barrier and digital options are useful tools and are not inherently improper to use. These products are already covered by effective market abuse legislation and do not require special attention or disclosure.

***Market microstructure***

***Q4: Does the market microstructure of specific FICC markets — including trading structures, transparency, asset heterogeneity or market access — enhance or diminish fairness and effectiveness? Where there are deficiencies, will recent or in-train regulatory or technological changes improve the situation, or are further steps needed? How do these answers vary across jurisdictions, or specific markets within FICC?***

Insofar as FICC markets each carry their own peculiarities and challenges that may affect fairness and effectiveness, MiFID II/R will homogenise the approach taken to different markets.

Microstructure improvements such as electronic execution and transparency generally enhance fairness, but beyond the MiFID II/R developments, the need for further change should not be necessary. Provided regulations are calibrated carefully in order to maintain liquidity, the FICC market will be enhanced as a result of the measures. We should see how things develop before suggesting further change.

***In fixed income:***

***Q5: Is greater use of electronic trading venues for a wider range of market participants possible or desirable? Are there barriers preventing a shift to a more transparent market structure?***

Such shift is certainly possible and it appears to be moving in that direction. While we recognise post trade transparency as a benefit, it needs to be properly calibrated, e.g. size specific to the instrument, for large in scale trades and for illiquid instruments. The level of transparency in these complex markets cannot be one size fits all.

***Q6: Should standardisation be contemplated across a broader range of fixed income products? How could that be brought about?***

Yes, where appropriate. Some risks are not suitable for standardised mitigation techniques and risk is increased if 100% standardisation is pushed.

***Q9: Are there barriers impeding the development of more comprehensive netting and execution facilities for transacting foreign exchange fix orders?***

The market is already innovating in this space and, subject to sufficient collaboration by benchmark providers. It is unlikely that there would be any significant barriers to the creation of netting and execution facilities.

***In commodities:***

***Q10: Are there any material barriers preventing greater transparency in OTC commodity derivatives markets? If so, what could be done to remove them?***

Commodities are global products with an array of underlying assets and participants. The presence of numerous and diverse market participants is helpful for commercial players to effectively manage their risk to a commodity they produce or use in their business, whilst other participants choose to participate for speculative reasons. There is a natural asymmetry of information where producers and other underlying commercial market participants have a natural advantage with regard to certain information. These asymmetries are a cornerstone of competitive differences and were it the case that regulation sought to remove this asymmetry, there would be significant risk to competition and liquidity as there would be fewer incentives to participate.

That being said, end-users of commodities are involved in manufacture, agriculture and other real-economy activities, therefore the Review should be mindful that restricting the commodities markets may have a direct impact on non-financial economic activity.

It is worth noting that MiFID II/R, EMIR and REMIT (insofar as it relates to wholesale gas and electricity markets) will bring about a significant shift in the market and introduce greater transparency. In particular, these pieces of legislation will regulate screen- and voice-brokered platforms (OTFs) across Europe introduce position reporting to regulators and transaction reporting to trade repositories. Once these regulations have been fully implemented, it will be possible to assess the existence of gaps and the need for further intervention. Any earlier action could potentially disrupt or duplicate work.

We encourage the Review to consider whether potential issues are UK-specific or European or international in nature. This assessment is important when considering introducing further measures in the UK, as the potential for regulatory arbitrage could force market participants away from the UK.

***Regulatory measures:***

***Q11: Are there any areas of FICC markets where regulatory measures or internationally co-ordinated regulatory action are necessary to address fundamental structural problems that exist?***

Global coordination and regulatory convergence are crucial, especially in the post-trade space. Due to differences in implementation timelines, the market participants who choose to become compliant in a timely manner may suffer unfair competition from market participants that are delaying implementation; this includes e.g. competitors offering lower margins due to lower risk management requirements, compliance costs and others. Such discrepancies can have negative impact on markets and most importantly create systemic risk.

Since the advent of Dodd-Frank, we have observed a balkanisation of liquidity between US and ‘Rest of the World’ liquidity pools. The advent of MiFID II/R risks amplifying the balkanisation and turn formerly global markets into ineffective and more costly local trading centres.

It is important that regulatory authorities work on global solutions where their actions relate to global markets, which includes fair and equal treatment for third country entities to access local markets and consistent enforcement actions.

**Conflicts of interest and information flows**

***Q12: Where do potential conflicts of interest arise in the various FICC markets, and how do they affect the use and potential abuse of confidential information, both within and between firms?***

The question surrounds conflict management in FICC markets and control over information flow. Where conflicts arise, a disclosure should be made to ensure adequate compliance and conflict management processes are in place to address the conflict.

There are no gaps to be filled with regard to principles, laws, further regulation and market abuse regimes. Sufficient regulation already exists. What we can observe is regulation based on the nature of the institution rather than based on the function that is carried out by the firm in question. It would be preferable to review existing regulation to ensure a functional application of rules. It is important to note that some firms participate in markets because they have to, and some volunteer to do so.

There is an evident disconnect between regulated and unregulated firms. We believe that regulation is sufficient, but its scope and application is not equal and it is not supported from the top down. Furthermore, there are some unregulated firms who fall under the Market Abuse regime.

The existing market abuse regimes focus on vertical integration and on the use and sharing of information between different parts of the business.

It is difficult to determine the scope of current regulation particularly with regard to conflicts between acting principal or/and agent.

The question to be asked is “to what extent should people having access to information from their ownership of physical assets, be allowed to use that information in the financial markets”.

There are tools already established, but enforcement and fines need to be applied consistently and sanctions are significant tools to act in a deterring capacity. The issue of inappropriate behaviour has gone unpunished and this cannot be allowed to continue and needs to be punished with the existing tools. Therefore, management of conflicts should be applied equally. The greatest sanction that could be imposed is the removal of a licence to trade, including criminal sanctions and public scrutiny where possible.

***Q13: How can the vulnerabilities posed by such conflicts be reduced? Are existing internal structures and control procedures sufficient? Where they are not, are further internal management controls required (such as better trading floor design and/or closer monitoring of electronic communications within and between firms) or is more radical action required to remove conflicts altogether?***

A large majority of firms are set up in a way so as to avoid conflicts, by having established conflict management processes and procedures.

We strongly believe that regulated firms are already subject to stringent requirements and do not merit more regulation. Radical action with regard to these firms is not required.

If a firm were required to disclose all information about its operations, it would most certainly have a negative impact on its ability to be competitive in the market.

The desire to remove conflicts of interest in FICC markets altogether could result in either a lack of information being shared throughout the firm or shared information across the market that could promote better competition.

It is understood that a potential conflict could arise from the capacity in which one acts in the market – i.e. as principal or as agent. Therefore, clarity is needed with regard to who is acting in what capacity. We acknowledge there are already sufficient rules – however, better disclosure is required regarding the capacity in which a market participant participates in the market, and the scope of the rules being applied.

Excessive prescription on best execution should be avoided, to allow natural developments in the market to take hold. CESR has provided a number of scenarios under MiFID I in which a firm acting in a proprietary capacity still owes best execution to their clients.

In the area of administration of benchmarks, there may be a need to create a more consistent regulatory framework – this objective will be addressed through the proposed and incoming European-level benchmarks regulation.

**Competition and market discipline**

***Q14: Is there a relationship between the level of competition in FICC markets globally and the fairness and effectiveness of those markets? What risks are posed by the increase in concentration seen in some FICC markets? In answering this, please have regard to the geographical scope of any relevant markets.***

Sound competition in the market is likely to result in higher levels of fairness and effectiveness for those markets, by introducing choice for clients/investors and putting downward pressure on fees charged for services.

This varies depending on the product – e.g. equity markets in Europe and US have fragmented into different liquidity pools and competition has increased, whilst derivatives have concentrated across fewer markets and become less competitive (participants squeezed into silos). It is notable that concentration makes it more challenging for new entrants to compete in these markets. Also, clearing members pulling out of markets is detrimental to what the G20 wanted to achieve, regarding mandatory clearing.

The risks posed by an increase in concentration can be seen in the ability of participants to influence the price action in a market and price upwards, destroying competition rather than enhancing it. We have also witnessed increased volatility in market segments where market makers have had to reduce activity in light of regulatory provisions.

Pan-European insolvency law still needs to catch up in some respects – derivatives markets may become a lot more expensive to access and cause participants to leave the market altogether (therefore draining liquidity), potentially leaving excessive risk unhedged.

There is the potential for the regulatory arbitrage that was experienced in the US, with commodities businesses moving from one jurisdiction to another.

Furthermore, concentration in some FICC markets may result in lower diversification of assets classes.

The FEMR mentions that financial institutions are not heavily involved in physical commodity markets. Industry believes this is a result of regulation, in particular the impact of regulatory capital rules.

Consideration should also be given to the discussion if the introduction of fairness into the markets may have potentially detrimental effects.

Furthermore, regulation has the tendency to move too fast and in instances can remove competition. It was also noted that regulation has the capability of moving risk in another direction as opposed to removing it completely. By imposing regulation that mandates the migration of OTC derivatives into central clearing, the result is a concentration of risk across a relatively small number of major CCPs. However, such transactions cleared through CCPs are risk managed by aggregating systemic risk from each player, in so doing CCPs were not creating new risks, but all market risks were moved into CCPs. Further examples can be seen in insolvency law and indirect clearing.

The derivatives markets have subsequently become more expensive for derivatives users. Fund or end-users may stop using derivatives for hedging purposes, which will create the unwelcome outcome that risk will go unmanaged.

**Promoting effective competition through market forces:**

***Q15: To the extent that competition is currently ineffective in any of the FICC markets, are there market-led initiatives, technological or structural changes that may remedy this situation?***

There has been a natural evolution in markets towards ‘electrification’ of trading and broking. Some markets do not lend themselves to that evolution of natural illiquidity. There is potential to artificially concentrate liquidity by restricting trading windows, furthermore, restrictions on trading could result in the stifling of innovation. For example, within the LME Select market, there has been an increase in the minimum tick size, which may have the result of reducing competition as smaller market participants may have difficulties to trading the new tick sizes. We would recommend that markets should be allowed to determine these issues for themselves.

Are there ineffective markets? There are naturally illiquid, specialist markets.

In the context of the definition of ‘effective’, (based on the FEMR definition of “effective”, FICC markets are effective), one feature of an effective market is that one can obtain prices in a reliable manner therefore, most markets are effective.

It is acknowledged that markets require innovation to develop further and to establish and maintain efficiency. It is noteworthy that markets cannot realistically be risk-free. It is competition that drives markets to be as effective as they can be.

In terms of technological and structural changes, regulation was driven into the markets at high speed, requiring extensive technological changes to existing systems leading to the creation of new and additional risks at member firms (operations). In contrast, innovations such as compression and risk re-balancing services that have the potential to alleviate some of the capital and collateral pressures have been inadvertently been hampered by regulation. It is important that the regulatory framework takes account of and supports these innovative services.

***Q16: Are there any lessons that can be drawn from experiences in other financial markets (or indeed other markets) about the ways that alternative or evolving market structures could impact on competition in FICC markets?***

The desired outcome seems to be that regulators want to have prices on screens. This follows on from the incentive schemes to support liquidity and to encourage participants to allow the prices to be displayed.

If prices for standard products are on screen, liquidity tends to increase.

***Q17: How effective is market discipline in enforcing sound market practices in each of the key FICC markets? What could be done to strengthen it?***

We understand the question to be “can FICC markets regulate themselves?” Are FEMR looking to regulate individual markets (e.g. FX, Bullion)? If we look at the example of bullion, many participants in the bullion market are already regulated.

Firms are likely to distinguish between regulated and unregulated products in the way that they are treated; therefore increasing the scope of regulation may end up with unintended consequences of bringing unregulated products into scope, and cause problems for end users.

Some products and firms are regulated, some products and firms are not which leads to confusion. We are not in favour of all products being regulated products due to likely unintended consequences.

The type of market discipline will necessarily depend on the nature of the market in question and solutions should be tailored appropriately.

**Promoting effective competition through regulatory and legislative initiatives:**

***Q18: In what ways might competition in any of the key FICC markets usefully be addressed by competition authorities (e.g. by assessing the state of competition in relevant markets)?***

The derivatives markets are global. Any action by an individual jurisdiction that is out of step with actions taken in a coordinated, controlled, fashion by fellow regulators in other major relevant EU and non-EU markets risks causing a fragmentation of liquidity (so hampering the ability of end users to risk manage their exposures as part of their legitimate hedging strategies) and significant market disruption (as users and service providers move their business outside of the UK).

Further, the UK acting unilaterally could actively harm competition and choice in UK markets and result in an uneven playing field across Europe, in direct contravention of the intention expressed through the G20 commitments of Pittsburgh 2009

***Q19: Are there any additional regulatory reforms that could be helpful in promoting competition and market discipline in FICC markets?***

Overall, markets need to be given more time for incoming regulation to embed and settle in. MiFID II/R will introduce already greater transparency. Also, members feel that only once MiFID II/R, EMIR, the new Market Abuse regime and other regulatory initiatives like the European benchmark regulation have been fully implemented, will it be possible to assess the existence of any gaps and the need for further intervention. Fine-tuning of regulation is encouraged, take stock of what is in place, rather than creating new rules.

Regulators should focus on synchronizing implementation timelines and greater regulatory convergence in general – both European and global – in order to avoid regulatory arbitrage and potential unfair competition, as mentioned in the response to Q11. Harmonised regulation and a level playing field need to be introduced at an orderly pace which will be less damaging to the markets as there will be detrimental impacts for investment and economic growth. The complexity of rules has been shown to hinder innovation.

***Q20: Is there a need for better awareness and understanding of the existing competition framework among FICC market participants, both at firm and individual level? How do you think that might be best achieved?***

Competition law is very complex. Educational exercises would be helpful to assist the market's understanding of the rules.

Firms and market participants are always required and encouraged to keep its employees informed about competition rules. There is already awareness in the market that training and further education is a necessity and trade associations play a central role facilitating this awareness. Considering that the FCA now has a competition mandate, the FCA is encouraged to make its mandate visible by providing educational sessions for the industry, and specifically with regards to the new enforcement powers coming into place in April 2015. The more complex rules are, the more the need for awareness and training. The FCA and the Competent Markets Authority (CMA) can play a central role here. It is important to establish how well the two authorities interact, and their willingness to co-operate with the industry. Consolidated regulation instead of 'regulatory reactions' (which lead to unintended consequences), will go a long way to aid market participants' awareness and understanding of the existing competition framework. On a global level, it would appear that the regulatory pendulum is leaning towards more co-ordination and (hopefully) the understanding that regulators need to ensure that regulation is consistent and does not create additional issues for the industry (e.g. OTC markets are global markets and require global solutions). It is also important that the industry has sufficient time to digest proposed and regulation, that is in effect already.

**Benchmarks**

***Q21: Do current domestic and international initiatives by industry and regulators to improve the robustness of benchmarks go far enough, or are further measures required?***

The major concern of market participants has been harmonisation, or the potential lack thereof. It is understood that HM Treasury's position on benchmark regulation as undertaken by HMT is broadly aligned with the IOSCO principles. However, at a European level, the concern is that some member states are in favour of a broader regime, which may have repercussions on third country users and administrators, particularly in relation to recognition of third country regimes.

It is understood that the current EU initiative is not favoured by a number of member states and the scope is likely to be reduced, which may lead to potentially damaging consequences for users.

Whilst an appropriate regime for benchmarks should be in place, we encourage the major global regulators to reach a common standing on the scope of benchmark regulation, with particular focus on recognition of third country regimes, so as to avoid any damaging consequences.

Similar concerns about the need for a coordinated, global approach to the regulation of benchmarks were made by CFTC chairman Timothy Massad, in connection with proposed EU legislation. In a recent speech, Massad said the EU approach "would have adverse market consequences. In particular, benchmarks created by administrators located in countries outside the EU could not be used by European supervised entities, such as banks and asset managers; unless the European Commission determines that any non-EU administrator is authorized and equivalently supervised in the non-EU country."

Given that the US does not have such a government sponsored supervisory regime for benchmarks and in light of the EU's equivalence standards, the proposed EU regulation "could prohibit EU institutions from hedging using thousands of products traded on US futures exchanges and swap execution facilities," Massad cautioned.

Like others, Massad has encouraged European officials to consider the work of the International Organization of Securities Commissions (IOSCO) in this area.

Meanwhile, the latest draft report on the European Parliament's proposed regulation echoes concerns about unilateral approaches to regulating what are essentially global instruments. Rapporteur Cora van Nieuwenhiuzen's report warns that divergent approaches from individual member states: "would result in fragmentation of the internal market since administrators and users of benchmarks would be subject to different rules in different Member States. Thus, benchmarks produced in one Member State could be prevented from being used in other Member States. In the absence of a harmonised framework to ensure the accuracy and integrity of benchmarks used in financial instruments and financial contracts in the EU, it is therefore likely that differences in Member States legislation will create obstacles to the smooth functioning of the internal market for the provision of benchmarks."

***Industry-level measures***

***Q22: What steps could be taken to reduce the reliance of asset managers and other investors on benchmarks?***

Benchmarks play an important role for buy-side and sell-side market participants alike. There should not be reduced reliance on benchmarks, but sufficient assurances that benchmarks are governed and used appropriately. We draw attention of the Review to the price formation and fixing processes, which require more transparency.

The IOSCO principles on benchmarks already propose transparency requirements and we encourage alignment with the IOSCO principles. We also encourage the Review to seek feedback from the buy-side to ensure that a holistic market view is being taken.

***Q23: What additional changes could be made to the design, construction and governance of benchmarks?***

There is a wealth of regulatory dialogue on benchmarks, encompassing the proposed EU and domestic regulation, the IOSCO principles and the Wheatley review. Whilst the substance of the regulations is sufficient, we encourage the Review to consider the scope of regulation in relation to the design, construction and governance of benchmarks. We also encourage the Review to ensure proportionality in the regulation, in relation to submitters and administrators as well as users so as to ensure transparency and workability, and ensure the presence of willing contributors to benchmarks. It is also important that proportionality is applied where benchmarks are constructed purely from regulated transaction data.

Furthermore, in the spirit of harmonisation, we encourage the Review to engage with other National Competent Authorities (NCAs) and international regulators to harmonise the language and principles (in particular the ESMA principles relating to benchmarks published on 6 June 2013) such that they can be used interchangeably.

As a final step, and following the finalisation of global standards, it is important to ensure standards are applied consistently to avoid any form of regulatory arbitrage.

***Q24: Should there be an industry panel to discuss benchmark use and design with the aim of assisting industry transition?***

Industry engagement in the promulgation process is essential and can help deliver sensible and proportionate outcomes.

***Regulatory action***

***Q25: What further measures are necessary to ensure full compliance with the IOSCO Principles for financial benchmarks by all benchmark providers?***

Compliance with the IOSCO Principles for financial benchmarks would be optimal, given the necessity for harmonisation to achieve an effective global regime. However, the difficulty with this is that the IOSCO Principles are not legally binding, and trying to implement the IOSCO principles on a national level may require significant redrafting if the IOSCO Principles are subsequently updated. A potential solution could be to implement a regime that aligns the IOSCO principles but allows European regulators to maintain control and oversight within Europe.

***Q26: How can the regulatory framework provide protection to market participants for benchmarks administered in other jurisdictions in a proportionate way?***

Global benchmark administrators or submitters should be encouraged to be open and transparent about their signing up to IOSCO (or indeed similar) principles, underlying their commitment to consumer protection. In practical terms, it may prove problematic to ensure that such third country submitters or administrators voluntarily submit to a code of conduct which may impose requirements beyond their interest. In this respect, we encourage the Review to promote the IOSCO principles, whilst taking into account potential consequences for third country participants.

**Standards of market practice**

***Q27: Are existing sources of information regarding standards of market practice across FICC markets globally: (a) already sufficiently clear (or will be once current regulatory reform has concluded); (b) sufficient, but in need of clearer communication or education efforts; or (c) not sufficiently clear, requiring more specific guidance or rules to provide more detail or close genuine gaps?***

Please refer to the response to Q 28.

***Q28: Box 7 on pages 36–37 discusses a number of uncertainties over FICC market practices reported by market participants, including: the need for greater clarity over when a firm is acting in a principal or an agency capacity; reported difficulties distinguishing between legitimate trading activity and inappropriate front-running or market manipulation; and standards for internal and external communication of market activity. To the extent that there are uncertainties among participants in the different FICC markets over how they should apply existing market standards in less clear-cut situations, what are they?***

There have been concerns around training and education and what is deemed appropriate behaviour. We recommend that regulators identify what is deemed inappropriate behaviour so that the industry can respond appropriately.

We suggest that the regulatory authority encourage the creation of a FICC market-wide code of market conduct, including a practitioner panel able to discipline perceived misconduct.

This should go hand in hand with clear regulatory expectations of appropriate market conduct.

Considering that FICC markets are global markets and require global solution, such a FICC market-wide code of conduct supported by a practitioner panel could potentially collaborate with a global regulatory college. An example for a global regulatory college is the college/forum formed under the OTC Derivatives Regulators Forum (ODRF). Regulators in the ODRF seek to obtain a common understanding of the operations of and services being provided by OTC derivatives central counterparties (CCPs) and trade repositories (TRs) that serve the global market. The purpose of such groups is to develop outlines for CCPs and TRs to use in drafting "plain language summaries" (PLS) of their operations and services. It should be examined if this concept could play a role in developing a global solution for a code of conduct.

***Q29: How could any perceived need to reduce uncertainties best be addressed: (a) better education about existing standards; (b) new or more detailed market codes on practices or appropriate controls; or (c) new or more detailed regulatory requirements?***

A pragmatic approach could be to leave the development of practice standards to trade organisations or other bodies looking at good practice (considering the good track record in this area).

***Will these uncertainties be dealt with by current reforms?***

***Q30: How can the industry, firms and regulators improve the understanding of existing codes and regulations by FICC market participants and their managers?***

The introduction of formal qualifications and examinations could act as a threshold for the markets. Additionally, refresher courses such as CPD can be used to update knowledge and behaviour.

***Q31: Should there be professional qualifications for individuals operating in FICC markets? Are there lessons to learn from other jurisdictions — for example, the Financial Industry Regulatory Authority's General Securities Representative (or 'Series 7') exam?***

It may be useful to compare the range of issues we are seeing at a European Union level and globally. For example, in the Netherlands, the banker's oath is currently mandatory for senior management/boards of Dutch financial institutions. On 1st January 2015, all new employees will have to take the oath and by 2016 all existing employees (regardless of their position). Furthermore, based on an industry initiative by the Dutch Bankers Association, disciplinary law will be introduced for all banking employees.

The Dutch Securities Institute (DSI) Public Register and Examinations started out as an initiative by Euronext in 1999. At present, it is the main self-regulating body for securities professionals managed by the industry itself. It upholds a code of conduct, has integrity guidelines and its own framework of rights & duties for professionals. DSI maintains a public register of professionals and provides pre-employment screenings for the majority of the industry. On the FICC side, registration as a securities trader or investment advisor requires an examination before one can be included in the public register. In practice, one cannot be employed in this profession if one is not registered with DSI.

We recommend that Industry Trade Associations provide ethics training for traders. We believe that an industry led and sponsored initiative would have considerable impact.

***Can the industry help to establish better standards of market practice?***

***Q32: What role can market codes of practice play in establishing, or reinforcing existing, standards of acceptable market conduct across international FICC markets?***

We believe there are too many Codes of Conduct. However, they can play an important role as long as there is a global and consistent approach to market standards (which we currently do not have in place).

A Code of Response could be implemented for those who breach the code. A code of response provides an operating framework; for example, participants would not employ individuals who have broken the code of conduct. Further examples would be naming and shaming individuals and blocking access.

We believe that the current regime tries to employ this method to maintain market conduct but it has been largely ineffective due to fear of being sued.

We recommend that regulators should consider existing tools and the shortcomings of enforcement.

***Q33: How would any code tackle the design issues discussed in Section 5.4.3, i.e.: how to ensure it can be made sustainable given industry innovation over time? How to differentiate it from existing codes? How to give it teeth (in particular through endorsement by regulatory authorities or an international standard setting body)? How to communicate it to trading teams? Whether, and how, to customise it for individual asset classes?***

Regulations will have to change in order to facilitate high level standards of behaviour and more responsibility needs to be placed with individuals and at corporate level.

***Should the scope of regulation be extended?***

***Q35: Are there any financial instruments that should be brought more fully into the scope of regulation in order to improve the fairness and effectiveness of specific FICC markets? For any instruments proposed: (a) what protections does the current framework provide; (b) what gaps remain of relevance to fairness and effectiveness; and (c) what is the cost/benefit case, bearing in mind the Review's Terms of Reference as set out in Section 1?***

The scope of commodity contracts that are in the scope of MiFID has always been uncertain, particularly regarding physical forwards traded on certain trading venues. Market participants need legal certainty and want to know precisely what are the boundaries of the definition of financial instruments are. In the context of the implementation of MiFID II/R, it is important for market participants to have a list of platforms registered as OTFs to assess what the scope of financial instruments will be.

**Responsibilities, governance and incentives**

***Q36: How much of a role did inadequate governance, accountability and incentive arrangements play in the recent FICC market abuses, and to what extent do these remain potential vulnerabilities in FICC markets globally? In addition to on-going regulatory changes, what further steps can firms take to embed good conduct standards in their internal processes and governance frameworks? And how can the authorities, either internationally or domestically, help to reinforce that process, whether through articulating or incentivising good practice, or through further regulatory steps?***

The structures around incentives have historically been problematic. However, the current regulatory initiatives to take on remuneration practices (i.e. bonuses) should be sufficient in addressing these shortcomings.

Incentives have a significant role to play. Incentives can be achieved by placing responsibility in the hands of individuals and senior management and making them accountable. This approach is supported by the FCA. We are supportive of incentives being realised over longer periods with claw-back capacity.

The culture of a firm is also a vital in implementing and maintaining good conduct standards. A strong ethical culture will enable a firm to react to difficult situations and acknowledge certain types of behaviour that are unacceptable. A strong culture need to be prevalent throughout a firm, from board members to individuals. There are many firms who have or are in the process of putting programmes in place. However, we believe it is too early to say what needs to be done or improved as many of these programmes are not fully implemented.

The focus must be on the harmonisation of existing regulation and effective channels of communication with the entire market. Furthermore, an expectation should be placed on all firms regardless of their regulatory status.

It should also be noted that conduct goes further than regulatory practices. Good practice should be incentivised and feedback (good or bad practice) should be given.

***Firm-wide initiatives to improve incentives and governance***

***Q37: Do respondents' agree that the thematic areas highlighted in Section 5.5 are key priorities for FICC firms (fine-tuning performance measures; adjustments to remuneration; attitudes towards hiring, promotion and advancement; closer board involvement in governance of FICC activities; and clearer front line responsibilities)? What specific solutions to these challenges have worked well, or could work well? And how best can the authorities help to support these initiatives***

Yes.

Frontline key responsibilities – three line defence strengthening should be implemented throughout a firm, not just frontline key responsibilities.

It is difficult to comment on each and every solution as they have only just been implemented. Firms and individuals need to be given more time to see what will happen as a result of implementing specific solutions, this includes the development of the cultural and governance changes within firms.

We believe that firm should be able to react prior to the introduction of more regulation. Harmonisation of regulation is key in allowing time to react to existing initiatives. Market participants favour a culture of cooperation between industry and regulators on regional, EU and international level with all market participants covered by regulation.

***Market wide initiatives to align market conduct, incentives and governance***

***Q38: To what extent could the Banking Standards Review Council help FICC market participants to raise standards collectively — in particular, are there other steps that could be taken to help complement or extend this initiative in FICC markets for non-banks and internationally?***

The Banking Standards Review Council could raise standards collectively by reaching out to other regulators to harmonise standards.

It should be noted that not all participants are captured by the same standards. We therefore recommend that it would be beneficial to have a framework/benchmark of expectation for the industry instead of a prescriptive list of expectations.

Harmonisation is key in working with global standards. It will enforce a commonality on expectations and timeframes.

***Regulatory initiatives to improve governance and incentives***

***Q39: Are there other regulatory measures the authorities could take to strengthen personal accountability or otherwise improve the way firms manage incentives and governance? In particular, should any or all of the measures in the Senior Managers and Certification regime be extended to non-bank firms active in FICC markets?***

The strengthening of personal accountability and improvements of incentives will assist firms in managing incentives and governance. However, the industry needs time to assess if these measures are working.

There are concerns about responsibility and risks which may lead to firms exiting the market which may severely impact the ability of the markets to innovate. Similarities are drawn to the benchmark discussion.

The extension of regulation to non-bank firms will be difficult to achieve due to the broad types of clients. This requires harmonisation. If measures can be harmonised, precautionary action would be desirable.

**Surveillance and penalties**

***Q40: What role can more effective surveillance and penalties for wrongdoing play in improving the fairness and effectiveness of FICC markets globally? How can firms and the industry as a whole step up their efforts in this area? And are there areas where regulatory supervision, surveillance or enforcement in FICC markets could be further strengthened?***

The current large penalties are effective. We recommend the use of existing tools rather than new regulations.

MIFID II/R trade reporting and REMIT reporting will make it easier to benchmark performance and capture untoward activity. Regulators should revisit reporting regimes to identify the appropriate data sets and information required to adequately monitor markets.

Surveillance improvements are expensive and slow; therefore firms should be allowed to react to regulatory change.

We recommend regular engagement with industry to enable regulators to better understand the industry. Regulators also need better tools to make sense of the trade/transaction reporting data that they are receiving.

***Firm level surveillance***

***Q41: How can firms increase the effectiveness of their own surveillance efforts across FICC markets globally? What role could the industry play in helping to explore best practices on how to make whistleblowing and other similar regimes more effective? Is there scope to make greater use of large scale market data sets and electronic voice surveillance to help detect cases of abuse in FICC markets? Are there other potentially effective tools?***

Further engagement is recommended with the industry to discuss how the effectiveness of surveillance systems can be increased.

Awareness exists in the industry that more could be done, and it is a high priority for firms within FICC markets to be proactive in identifying the appropriate and inappropriate conduct. We believe that the effectiveness of surveillance tools is working, for example, there is already increased focus in firms on appropriate benchmark activity. However, there needs to be more harmonisation within firms, across all levels.

The benefits of whistle blowing particularly in the United States, has had a significant impact. We believe similar measures could be introduced at UK and European level to reward whistle blowers. Furthermore, harmonisation of whistle blowing policy and procedures need to be in place.

Firms do not have available large data sets, as such quantities of data are held at the regulators and/or trade repositories. To make use of such data, we would recommend that the industry engages with regulators to give more specific data sets. We believe that it is important for the industry to assist regulators in the effective and efficient use of data. Furthermore, the industry welcomes any opportunity to inform and educate regulators' understanding of the markets.

***Firm level penalties***

***Q42: Are there processes or structures that can allow firms to punish malpractice by their own staff more effectively (for example, penalties for breaching internal guidelines)?***

Yes. There are already tools in place and additionally, firms have their own standards and are proactive in enforcing these rules.

***Regulatory-level penalties***

***Q46: What further steps could regulators take to enhance the impact of enforcement action in FICC markets?***

The key evolution of insider trading is the implementation of criminal sanctions and naming and shaming. In addition, there should be more significant application of the existing framework. We believe that harmonisation of the existing framework would extend the scope of coverage of regulations. MIFID II/R and MAD already extend the scope of coverage.

We recommend that addressing persistent behaviour can be achieved by linking market initiatives to regulatory initiatives.

***Q47: Should consideration be given to greater use of early intervention, for example, temporary suspension of permission for a particular trading activity for firms or individuals or increased capital charges?***

Early intervention, whatever it may be, requires evidence. Regulators should be mindful of the impact on the market, particularly where markets are bespoke.