Response by the:

Market Practitioner Panel

to the:

Fair and Effective Markets Review

January, 2015

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Executive Summary

1.1 Introduction

When the Chancellor of the Exchequer established the Fair and Effective Markets Review (FEMR) of wholesale Fixed Income, Currency and Commodities (FICC) markets in June 2014, its terms of reference provided for the formation of an independent Market Practitioner Panel (MPP).

The MPP membership includes senior industry leaders from investment banking and asset management firms, market infrastructure providers, major corporate users of financial markets and a number of independent members with deep experience of the industry, its regulation and evolving codes and standards.

Members of the MPP participate in a personal capacity rather than representing the views of their organisations. We have benefitted from the input of Expert Groups with specialist knowledge of FICC markets, a senior lawyer with markets experience and pro-bono support provided by various firms, for which we are very grateful.

Whilst acknowledging that large parts of the financial services sector serve clients well, it is self-evident that the abuses which have occurred, including those in LIBOR and FX, were both widespread and totally unacceptable. They happened within a number of firms arising from the actions of individuals whose behaviour was not excusable even in the absence of clarity over standards of acceptable market practice.

The FEMR consultation document identified that, quite apart from these well publicised abuses, there were further 'grey areas' across FICC wholesale markets where there remains some uncertainty over what constitutes acceptable market practice. These uncertainties have not been tested by regulators and are likely to continue in the absence of authoritative guidance.

1.2 The nature of FICC Markets

FICC markets are global. They evolve constantly, sometimes rapidly, driven by significant forces such as changes in macro and micro economic conditions, regulatory action, customer demand, technological advances and developing patterns of global trade. The market is currently in a heightened state of transition as new regulations are implemented and take full effect. Therefore any intervention aimed at improving their fairness and effectiveness needs to take these factors into account.

Further, although FEMR did a commendable job in highlighting issues in FICC markets, new questions will arise, even as known ones are addressed. New practices will develop, innovations will arise, new venues will emerge and new instruments will be created, which will trigger unanticipated issues. The heterogeneity of FICC markets is a further challenge to be overcome.

Although some market participants would welcome very definitive rules (as opposed to principles and standards) it is (virtually) impossible to envisage a sufficiently detailed and comprehensive rule book for FICC wholesale markets that would remain current and precise, without considerable and constant dedication of expert resources.

Does this mean that the drive for enhanced fairness and effectiveness should be consigned to the 'too difficult box'? Absolutely not. **The MPP recognises that concerted action must be taken in order to enhance confidence and to rebuild and reinforce a trustworthy reputation at the heart of FICC markets, substantial portions of which sit here**

in the UK. We also recognise that it is the responsibility of industry participants to work with our regulators to make this happen.

1.3 Impact of the FEMR Review and Consultation

FEMR has acted as an invaluable catalyst for constructive industry engagement, bringing together, for the first time in a focused way, market practitioners across sectors, including important representation of international firms, many of which are leaders in FICC markets. **It has been a stimulus for individual firms and the industry as a whole to respond positively and urgently.**

In presenting our response, the MPP not only answers the specific questions raised in the consultation but also reaffirms its commitment to work with others in the industry and with the Review team to devise practical ways to enhance the fairness and effectiveness of FICC markets in the UK, and, we hope, beyond.

1.4 Continuing and broadening engagement

The MPP recognises that enhancing fairness and effectiveness in FICC markets will require a coordinated, concerted and sustained response by the industry, working together with policymakers and regulators on a continuing basis. Further, we hope that the Review will trigger an international dialogue among policy makers such that the actions arising can influence these essentially global markets.

Members of the MPP, and many others who have approached us, have confirmed their willingness to engage in order to raise standards and thus confidence in the fairness and effectiveness of these markets.

In summarising our response we have taken as a framework Table A from the consultation document (reproduced on page 10 for ease of reference).

1.5 Structure or Conduct?

In terms of the scale of change necessary, we do not consider that FICC markets are fundamentally or irretrievably broken and in need of significant structural reform. Competition is fierce and the nature of wholesale markets is such that participants are typically knowledgeable, experienced and often expert. That said, there clearly are information asymmetries. The consequences of these and the conflicts of interest arising from them need to be addressed, particularly as public confidence in the FICC markets has been severely shaken.

Developments in technology, broadening market access and enhancements to transparency that will emerge from in-train regulation have led us to conclude that significant reforms to market structure are already underway. Some specific opportunities to enhance this further are identified in our detailed response but in terms of balance of action, the MPP considers that Conduct is the area that requires most focus.

As noted by the Chairman of the Financial Stability Board[1]: *"Fundamental changes are necessary to rebuild trust in finance. Those practising in the industry must demonstrate exemplary behaviour, and be seen as serving end-users rather than their own interests."*

Three recurrent themes emerge from our work in response to the consultation:

(1) the need for **clear, consistent and sufficiently practical guidelines** on acceptable market conduct, including in specific areas where there is still divergent practice, and to translate these into straightforward language and examples that can be understood by all relevant employees;

(2) the need to establish more **consistency in codes and standards** applied across and within firms to ensure exemplary behaviour by all individuals; and

(3) the requirement to find **a means to capture and share best market practices** as they evolve.

1.6 Market, Firm, Individual and/or Regulatory Action?

The importance of ethics, and the limits to what regulation can achieve alone were well articulated by the Deputy Governor of the South African Reserve Bank[2] when he said: *"Further solutions do not lie principally in yet more regulation which would take time to implement. Instead the global industry must take matters into its own hands promptly to establish standards and change behaviour, with the support of the authorities."*

In the course of our work, firms have shared with us examples of best practice, developed as internal Codes of Conduct or Standards of Behaviour, and often embedded in statements of principle and codes of ethics that are already binding on employees. It is acknowledged, however, that no matter how strong the best practices are in the firms that have been leading the way in their own internal 'self-regulation', the reputation of and confidence in FICC markets can be undermined by weak governance or inappropriate practices by other participants.

In the remaining period of the MPP's life, we will continue to play an active role in channelling the industry response to developing FICC Standards and specific best practice examples and guidelines, while also looking for the right body / bodies to which we can pass the baton at the end of the Review.

1.6.1 Market Response

FICC markets are competitive and are generally considered to be effective. However, **competitiveness can be subverted by how people work in practice. Hence the heavier emphasis in our submission on behaviours, standards and guidelines for good and best practice.**

Concerning the corrective power of market forces, wholesale users of FICC markets are often obliged primarily to look for best execution, such that other considerations would typically play a secondary role in the determination of with whom to do business. Liquidity constraints in particular FICC markets will also sometimes act as a barrier to 'market

[1] Mark Carney, "The future of financial reform", speech to MAS, 17 November 2014
[2] Daniel Mminele, "Ethics in finance and financial markets" speech to ACI, 29 October 2014

discipline'. In our response we highlight where existing tools for market discipline could be strengthened.

At the industry level, **we advocate the establishment of a cross-sectoral industry-financed but demonstrably independent and respected body that will develop Codes and Standards for wholesale FICC markets**, and act as a focal point for the establishment of recognised best practices that can be translated into practical guidance, for example on trading floors. This body would provide guidelines and case studies to address specific 'grey areas' of conduct within FICC markets by drawing on the expertise of market practitioners and end-users.

Although the impetus for the establishment of this body comes from the UK because of the FEMR, clearly the more international engagement, the better the chances of being able to extend the best practice perimeter.

We have considered the key characteristics necessary for such a body to succeed but given the unique characteristics of FICC markets and the requirement that this body is cross-sectoral, more work now needs to be done to flesh out the specific priorities, structure, resourcing and relationship with regulators.

In order to do this, the MPP will engage with existing Standards bodies, most notably within the UK the Banking Standards Review Council, but also with other bodies with relevant established codes of ethics or standards that can be built on, such as the Chartered Financial Analyst Institute (CFA); existing central bank FX Committee codes (including the in-flight code consolidation work through the Global FX Committee); the Association Cambiste Internationale (ACI); and groups with successful track records in other jurisdictions such as the Treasury Market Practices Group in the United States.

The considerable number of individual Codes and Standards developed by leading practitioners, means that there are also well developed firm-specific examples to draw on and these will contribute significantly.

1.6.2 Firms' Response

In addition to the industry initiatives, within our response we highlight what individual firms and their boards and senior management either are doing or, if not, should proceed to do. Given that **we place considerable focus on behaviours and conduct norms, most of our comments refer to processes that help to drive employee quality and the right organisational culture**.

There is widespread frustration within firms at their limited practical ability to deal with individuals who do not adhere to expected standards of conduct or behaviour. There is an acknowledgement that the practice of agreeing individual 'compromise' or 'settlement' agreements is unsatisfactory in that it can result in the exit of an individual from one firm, simply for them to become a 'rolling bad apple' and move on to the next.

Further expert attention is needed to consider the extent to which the Approved Persons Register might be developed into an industry source of information on the reasons for the departure of individuals. However, one has to be cognisant of the risks attached to such a register, and ensure that it has 'teeth' while also respecting an individual's rights.

This topic will also be developed further in the coming months by the MPP, while recognising that it has proven to be a 'tough nut to crack' in previous reviews.

In addition, our response covers the way in which firms contract with, supervise, evaluate and reward front line staff in a manner that is consistent with their values and expected standards of behaviour. In this respect, **individual accountability and the response of firms towards individuals who have not met these standards are paramount.**

1.6.3 Individuals

Licensing, or making wholesale banking a profession, has been suggested as a means to address individual performance and behaviour. This would require a body or bodies to train, test, sustain Continuous Professional Development, supervise and sanction individuals. A very substantial undertaking. Opinion within the MPP is split on whether exam-based professional qualifications are really a necessary part of the solution when the problems are seen to be grounded more in conduct than competence. We recognise that, over time, professional qualifications could reinforce (external perceptions of) professionalism and that there is scope for it to emerge from the work to be undertaken urgently on FICC Standards and Guidelines.

Individuals need to have instilled in them personal responsibility to ensure that the integrity of the market as a whole is respected, thus having a duty to call out unacceptable behaviour or concerns. We develop how this might be introduced and reinforced in our response. **In the meantime, and as a minimum, individuals should positively attest to their understanding of relevant internal and external standards on an annual basis, as is already practice in some firms.**

1.6.4 Regulators

With regard to regulation, and the role of regulators in FICC markets, the MPP noted the regulations already in-train and those yet to be implemented[3]. While we understand that further regulation might emerge from the Review, our primary input on the priorities for additional policy or regulatory intervention is:

(1) for **consistent implementation** of agreed regulation across markets (e.g. MiFID II, MiFIR);

(2) for a **means to enable greater engagement between the industry and regulators**, particularly in working to strengthen and endorse the FICC Codes, Standards and Guidance we envisage being developed;

(3) to provide a **framework to accelerate adoption** of guidelines; and

(4) to encourage the FSB and IOSCO to **promote increasing consistency** of the regulation of global markets **across jurisdictions** in order to reduce unnecessary cost and complexity.

The MPP has heard from across the FICC industry willingness to offer experienced resources to the authorities, for example in topic-specific working groups and / or as secondments in order to provide additional FICC market expertise where helpful.

On the question of extending the regulatory perimeter, spot FX and spot physical commodities are notable products out of scope of significant parts of regulation today (e.g. MiFID II, MiFIR and Dodd Frank). In light of recent examples of misconduct in the FX and commodities markets some have argued that these products should be brought more fully within the scope of regulation. Most of the MPP agree that these products should be brought within the scope of

[3] Please see appendix for detailed listing of all relevant FICC regulatory developments

regulation related to market conduct and behaviour.

However, it would be highly complex and potentially not feasible simply to read across from existing regulation (such as MiFID II or MiFIR) due to the different nature of market participants and the risks involved of burdening real economy activity given the many corporate users of these products.

Therefore, any extension of the regulatory perimeter would need to be carefully considered and potential unintended consequences assessed (for example impact of additional expense for corporate users or reduced competition).

1.7 Summary

The fairness and effectiveness of wholesale FICC markets is of significant importance not just to participants within those markets, but to the wider economy.

The MPP welcomes the opportunity to respond to this broad, forward looking review as a cross-sectoral group. It is absolutely critical that market participants are active in redressing many of the issues that have come to light in recent years, which served to undermine confidence in these markets.

Going forward the industry clearly has a critical role to play in contributing to the restoration and maintenance of confidence in the integrity of markets, particularly given its detailed technical and practical knowledge of how they operate.

Through its work thus far, the MPP has identified a series of steps that would help rebuild trust in FICC markets. We have placed more emphasis on measures to improve standards of conduct than on structural changes as it is in the realm of conduct where failings have been most apparent and where action should be most fruitful.

We appreciate that FEMR will continue until June 2015. Without wishing in any way to pre-empt the outcome of the review, the MPP is committed to continuing to work together, and with others in the market, in the coming months.

We have identified specific areas to focus on where depth of practitioner technical expertise will be essential in clarifying what is acceptable market practice and in the development of guidance. We intend to focus on these and thus help sustain the momentum created by FEMR.

Table A (a framework for evaluation the fairness and effectiveness of FICC markets) from the consultation document:

	Potential source of vulnerability	**Possible responses by**			
		Markets	**Firms**	**Individuals**	**Regulators/ Legislators**
Structure	Market microstructure				
	Competition and market discipline				
	Benchmarks				
Conduct	Standards of market practice				
	Responsibilities, governance and incentives				
	Surveillance and penalties				

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The MPP would like to thank the FEMR principals for this opportunity to contribute and also the many individuals and institutions who have been so generous with their time and advice.

In particular, we thank Oliver Wyman, KPMG and Linklaters who have dedicated professional, high quality resources who have contributed significantly to supporting our work thus far.

Defining 'fair and effective'

Question 01 – What does 'Fair and Effective' mean for FICC markets?

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?

1.1 Section 3 of the consultation document outlines definitions to describe what is meant by both 'fair' and 'effective' FICC markets. Broadly, the MPP agrees with the definitions provided and our views are discussed in more detail below.

Defining 'effective'

1.2 Two criteria for effective FICC markets are highlighted in the consultation:

(a) one that enables investment, funding and risk transfer; and

(b) one that provides competitive prices.

1.2.1 In expanding on these points, the MPP observes that the ability to transfer risk with reasonable execution costs and a low prospect of trade failure is critical for an effective market. Underpinning this, there needs to be sufficient liquidity to provide a market where ready and willing buyers and sellers are available on the most continuous basis possible. The MPP acknowledges the concerns described in the consultation document regarding potential dangers posed by under-priced liquidity and credit risk but, assuming that these risks are appropriately priced, would consider sufficient available liquidity a significant factor in defining an effective FICC market.

1.2.2 The availability of competitive prices is, in the view of the MPP, required in the definition of an effective market. An effective FICC market would have a breadth of market participants providing readily available, comparable, committed and executable prices at a reasonable cost of price discovery.

1.3 The MPP agrees that effective FICC markets should be resilient and should be regulated appropriately and proportionately. An effective FICC market should be sufficiently robust to continue to operate and maintain liquidity during times of market stress or in the event of the failure of infrastructure or a participant. A market that is designed to work well in benign market environments but fractures badly in periods of stress should not be considered effective. Markets should also be regulated in a way that provides consistency and prevents substantive negative outcomes without unnecessary costs or restrictions, which would impact effectiveness.

Defining 'fair'

1.4 The consultation document defines five criteria for fair FICC markets:

(a) Clear standards of market practice;

(b) Transparency;

(c) Open access;

(d) Competition on the basis of merit;

(e) Integrity.

1.4.1 In the view of the MPP, the consultation document correctly states that in a 'fair' market, market outcomes should result from consistently applied standards of market practice. Although these practices need not necessarily be uniform across all markets, participants and jurisdictions, they should be underpinned by consistency.

1.4.2 Transparency is a factor in fair FICC markets and the MPP agrees that as a minimum, data should be available to test adherence to agreed processes (e.g. best execution in an agency model).

1.4.3 The MPP agrees with the criteria for open access to FICC markets (either direct or through an intermediary) and believes that common criteria for access to trading venues and services is a characteristic of fair FICC markets.

1.4.4 The MPP considers the criteria of competition on the basis of merit in a fair FICC market as driven by two primary factors:

(a) the availability of choice for market participants; and

(b) that participants should be able to change to alternative options at a reasonable cost.

In the view of the MPP, ensuring both criteria are met would enable healthy merit-based competition. In terms of maintaining choice, the market ecosystem needs to have participants that are incentivised by sustainable commercial factors consistent with fairness outlined.

1.4.5 Finally, integrity is required within fair FICC markets. The MPP fully supports the principle that fair FICC markets should be free from manipulation or inappropriate trading.

Can there be trade-offs between fairness and effectiveness?

1.5 The view of the MPP is that, on the whole, the definitions of 'fair' and 'effective' provided by the consultation document strike the right balance between safeguarding the interests of end-users without unnecessarily impeding the effectiveness of FICC markets.

Question 02 – What does 'Fair and Effective' mean for FICC markets?

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?

2.1 The MPP has structured its response to the consultation document using the framework of the six themes identified by the Review, thereby addressing each element posed in Question 2.

2.2 Within certain markets there is potential for structural improvements and we have identified these in the body of our response.

2.3 However, as highlighted by the executive summary, the MPP considers the previous cases of FICC market abuse were broadly the result of conduct-related issues rather than inherent market structural deficiencies. In light of this, and as evidenced throughout the response, we are of the opinion that standards of market practice; responsibilities and incentives; and surveillance and penalties are strongly responsible, and inextricably linked, in relation to these past cases of FICC market misconduct which therefore require attention.

2.4 With regard to the question posed as to whether the framework applies differently to certain jurisdictions, the MPP considers that the global inconsistency of how market practices and conduct expectations are currently articulated through a patchwork of regulation, codes and practices exposes all jurisdictions to the possibility of misconduct and we strongly encourage an international focus on their remediation.

Section 1 – Market Microstructure

Question 03 – Barrier and digital options

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?

3.1 Barrier and digital options (i.e. options where the payoff is binary and dependent on the underlying reaching a pre-determined price either on a given date or over a given period) developed as a response to market participants' requirements for lower-cost alternatives to vanilla options to take positions or to hedge binary events.

3.2 These products create a potential for conflict of interest as the underlying security approaches the 'knock out' or 'knock in' price, or as the product approaches expiry. As outlined in Box 5 of the consultation document, it is difficult to distinguish between legitimate trades intended to hedge the impact of changes in the underlying reference rate and inappropriate trades intended to impact the rate (i.e. affect whether or not the option is triggered). Indeed, trades which are intended to hedge the impact of rate movements can impact the rate whether or not the option is triggered.

3.3 The issue of barrier and digital options is somewhat similar in nature, albeit at a far smaller scale, to those of orders at benchmark fixings (as discussed in our response to Question 9) or large auctions. Where markets develop risk concentrations because of either time specific events (i.e. issuance / maturities of large securities, fixings, close of reporting periods, tax events) or risk specific issues (i.e. barriers, option strikes, credit clause events, potential covenant breaches), the economic effect of any unfair or ineffective market practice could increase. Conflicts of interest and so-called behavioural 'grey areas' associated with them are at their most acute when a liquidity provider acting in a principal capacity accesses the market between the inception and conclusion of a transaction with a client, as is common with many of the product types above.

3.4 Therefore there are two responses to consider: (1) the elimination or banning of barrier and digital options; or (2) the application of intensified conflict of interest mitigation processes, preferably set within a consistent industry-wide guidance framework.

3.5 Option (1): The MPP suggests that it is not advisable to eliminate barrier or digital options given the end-user demand for such products. Any restriction would likely be ineffective as the characteristics can be substantially replicated using other instruments. However, the MPP recognises the immediate need to mitigate the risk of unfair practices and conflicts of interest associated with barrier or digital options.

3.6 Option (2): To mitigate the risk of unfair practices, the MPP recommends intense attention to and enforcement of, internal processes; and greater use of disclosures and suitability checks in the sales process.

3.7 In addition, the MPP proposes that industry-led market-wide FICC Guidelines and Case Studies are developed based on best practices to provide guidance on acceptable risk management in cases where there is elevated potential for conflicts of interest to arise. Further detail is provided below:

3.7.1 Risk management practices: The MPP recommends that firms offering digital and barrier options should have their own clear and transparent guidelines and controls governing which barrier trades they enter into; effective monitoring procedures including real-time recording of trading activity (as is already common practice); and the use of daily accrual mechanisms where possible. Such controls should enable first, second and third lines of defence to assess activity and whether its intent is for legitimate risk management purposes. Firms' guidelines, processes and controls should be disclosed and supported by (as yet to be developed) industry-wide FICC Guidelines and Case Studies covering all market participants that provide clear and granular guidance on what constitutes proportionate and commercially reasonable behaviour (see our response to Question 29 for further detail);

3.7.2 Client disclosures: The MPP recommends that common and consistent standards of disclosure are agreed that ensure participants are informed of their relationship with a dealer (i.e. agent or principal basis) and describe the requirement for the principal dealer to risk manage their position, the resulting conflict of interest and the potential implications;

3.7.3 Client suitability: The MPP recommends that providers of barrier options make an assessment of participants to ensure that barrier options are suitable, given the risks involved. Suitability guidelines should be set by the industry in order to ensure consistency across the market, although individual participants should be free to define their own standards over and above the industry minimum;

3.7.4 It is important to implement surveillance approaches, such as spot checks, to ensure adherence to the above practices.

Question 04 – Market microstructure - general

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?

Current market microstructure

4.1 The FICC markets have evolved over time to be large and, overall, effective. However, elements of the market structure and certain execution practices have been identified, which have or could diminish fairness and effectiveness. The broad elements that enhance the fairness and effectiveness of FICC wholesale markets include:

4.1.1 Market access: Markets on the whole are highly accessible to interested participants, particularly in more liquid products (G10 spot FX, government bonds, vanilla rates swaps, index CDS, physical commodities). There is a diversity of venues (Exchanges, Single Dealer Platforms and Multi Dealer Platforms), allowing participants to select between multiple venues to access the market. This has been enhanced by the growth of electronic trading and the standardisation of certain products (e.g. government bonds and CDS indices);

4.1.2 Pricing reflective of product liquidity and dealers' ability to risk manage positions: In highly liquid wholesale markets (such as G10 spot FX or vanilla rates) average bid-offer spreads are very low in non-stressed trading periods and have reduced over recent years. However, while tighter pricing can in some cases indicate a more effective market, this is not always the case. The MPP considers that greater disclosure on practices (e.g. last look and internalisation) that allow tighter pricing is required. For more detail, see our response to Question 8;

4.1.3 Product tailoring: The high level of tailoring of products across all asset classes allows end-users to hedge their positions effectively and accurately, reducing their basis risk. In the credit market, issuers have sufficient flexibility to place debt securities in the market that match their financing needs in terms of tenor, structure, notional and other factors;

4.1.4 Public post-trade transparency: Further enhancements to post-trade reporting are already underway, with requirements within MiFID II[4] in Europe and Dodd-Frank[5] in the US aiming to increase levels of post-trade reporting and improved transparency across a broad range of financial instruments;

[4] Markets in Financials Instruments Directive (MiFID): http://ec.europa.eu/finance/securities/isd/mifid/index_en.htm

[5] Dodd-Frank Wall Street Reform and Consumer Protection Act: https://www.sec.gov/about/laws/wallstreetreform-cpa.pdf

4.1.5 Increasing price transparency: Driven by technological advances, product standardisation in some areas, and regulation (e.g. MiFID I / II), trading volumes are increasingly moving to many-to-many, more accessible venues, increasing price transparency and price discovery.

4.2 **Elements that can diminish the fairness or effectiveness of the markets include:**

4.2.1 Lack of clarity on dealer role: Dealers can execute trades acting as either a principal or as an agent but the role they play when interacting with market participants may not always be clear. It is important that participants, especially new entrants, are aware of the role the dealer takes, particularly as agency-type execution increases. This is linked to the concerns raised over internalisation, which is an inherent feature of a principal-based market. See our response to Question 8 for more details;

4.2.2 Lack of common standards on use of non-public information: Information asymmetries characterise large parts of the FICC market, where participants may have access to confidential information on other participants or market movements. While such information is largely used for legitimate reasons (e.g. to manage positions and hedge risks), with no intent to move the market to their advantage, it may also give rise to conflicts of interest. See our response to Questions 12 and 13 for further discussion and recommendations;

4.2.3 Inconsistent regulation across regions: Given the global nature of FICC markets, regulatory differences across jurisdictions in recent and in-train regulation (e.g. different leverage ratio requirements in CRD IV[6] versus Federal Reserve Rule[7], or limitations placed on European-based managers subject to Article 17 of AIFMD[8]) create complexity, which could result over time in a reduction in market participants, and may create opportunities for regulatory arbitrage. Elements of this could be addressed through increased regulatory co-operation and convergence between the major financial jurisdictions, and is discussed in our response to Question 11;

4.2.4 Lack of market-wide suitability standards: There is currently a lack of market-wide standards for assessing end-user suitability. The introduction of IFRS9[9], which will simplify hedge accounting practices, may attract

[6] Capital Requirements Regulation and Directive (CRR / CRD IV): http://ec.europa.eu/finance/bank/regcapital/legislation-in-force/index_en.htm

[7] Federal Reserve Supplementary Leverage Ratio Final Rule: http://www.federalreserve.gov/newsevents/press/bcreg/20140408a.htm

[8] Alternative Investment Fund Managers Directive (AIFMD), FCA: http://www.fca.org.uk/firms/markets/international-markets/aifmd

[9] IFRS 9 Financial Instruments (replacement of IAS 39): http://www.ifrs.org/current-projects/iasb-projects/financial-instruments-a-replacement-of-ias-39-financial-instruments-recognitio/Pages/Financial-Instruments-Replacement-of-IAS-39.aspx

new and potentially less sophisticated participants to use derivatives products, which will further increase the importance of suitability assessment. Many firms have developed suitability or appropriateness standards, but there is little industry-wide alignment. To address the risk that the scope for interpretation diminishes market fairness, the MPP recommends a market-based solution to align and clarify suitability standards. It is the intention of the MPP to initiate work on these guidelines, drawing on senior market expertise available. See also our response to Question 11, point 11.4.2.;

4.2.5 Risk concentrations at a pre-defined end / fix or with pre-defined triggers, e.g. DMO closing, month-end, index-end or other fixed price points, barriers: In instances where dealers assume price risk and significant volume concentrates around a pre-defined time, there is a potential incentive for dealers to take positions or time trades to impact the fix prices in their favour. Whenever markets develop risk concentrations due to time specific or risk specific issues, the potential to misuse information increases. See our response to Question 3 for further discussion and recommended remedial action;

4.2.6 Concentration risk within CCPs (Central Counterparties)[10]: While the emphasis of global regulation to increase the level of clearing is seen as improving the fairness and transparency of the markets, there is a real risk of increased concentration within the larger CCPs and clearing brokers. Furthermore, there is an inherent conflict of interest between risk management and commerciality of CCPs in order to increase volume. The potential of a 'race to the bottom' in terms of risk mitigation standards needs to be addressed pro-actively. The MPP recommends a review, ideally globally, to ensure prudential oversight of CCPs and clearing brokers is commensurate with their growing position in the market structure, with particular focus on risk management processes; adequate financial resources; and recovery and resolution plans that are fair to all impacted participants;

4.2.7 Cross-subsidisation: The majority of the MPP strongly supports the relationship banking model in wholesale markets that, by focusing on a wider range of products and services, allows banks to develop a deeper understanding of clients' needs, also helping clients to manage operational and regulatory complexity. The 'through the cycle' relationship banking approach offers significant benefits to clients and to the wider market and is potentially more enduring in stressed conditions than a purely price-driven and commoditised market structure. However, within this model there are examples where commercial decisions can lead to under-pricing of certain products or services, offset by more profitable products or services. Examples in FICC markets and broader financial markets include cross-subsidisation between primary dealer issuance and secondary trading activities and between corporate vanilla lending and other

[10] http://www.esma.europa.eu/page/Central-Counterparties

products. There is a risk that selling an under-priced product or service could lead to pressure to sell other more profitable products or services to compensate. While there is recognition within the MPP that such cross-subsidisation could lead to conflicts, the majority believe that this can be managed through increased price transparency for bundled products and services, and standalone availability of products or services where they are not intrinsically linked.

4.3 It is worth noting that there are also elements that are idiosyncratic to individual asset classes that may diminish fairness or effectiveness:

4.3.1 Variable standards of syndicated issuance prospectuses in the credit market: There is a need to increase the rigour and professionalism in some High Yield (HY) issuances to bring them in line with the standards generally seen in Investment Grade (IG) issuances. There is scope for further standardisation of the content and timing of prospectuses to address this concern, as discussed in our response to Question 6;

4.3.2 Advantages of physical infrastructure access in the commodities markets: Full participation in some commodities markets requires, or is greatly aided by, access to sizable physical infrastructure (such as storage facilities). This makes some markets effectively wholesale-only and can offer vertically integrated participants with access to such facilities an information advantage. However, many market participants are able to acquire physical assets and so the associated information advantages are not limited to vertically integrated suppliers – for example, 'pure play traders' have recently been investing in infrastructure (either by acquisition or lease holding);

4.3.3 Limited published transaction data in Over-The-Counter (OTC) physical commodities markets: Outside regulated exchanges publicly available transaction data is limited and there is little or no regulation mandating trade transparency in physical markets. The high degree of standardisation and liquidity in some products could allow for greater post-trade transparency to be provided on an end of day basis, but care must be taken not to discourage execution-in-size or to encourage regulatory arbitrage and shifts to other jurisdictions. In some markets (e.g. Oil and Gas), deals are reported in pricing windows to aggregators such as Argus[11] or Platts[12], which provide more widely available public market pricing updates. This is discussed further in our response to Question 11, paragraph 11.5.

Jurisdiction variations

[11] http://www.argusmedia.com/
[12] http://www.platts.com/

4.4 The global nature of FICC markets acts as an impediment to the creation of communal structures or platforms for trading, whether principal or agency. The combination of idiosyncratic assets, heavy governmental issuance and involvement, the counterparty credit intensive nature and historical evolution of FICC markets have made it more OTC and bilateral than equities markets. It is clear to the MPP that fundamental changes to the structure of FICC markets, should they be deemed desirable, would require international consensus on core rules and structures.

Variation between products

4.5 FICC markets cover a whole spectrum of products, from illiquid to highly liquid. Clearly solutions or change for the more liquid markets may not be appropriate for the less liquid markets. The more liquid the market in general, the more opportunity for choice in principal versus agency execution models, in electronic matching and in transparency. The less liquid and more idiosyncratic the underlying instruments are, the more OTC and bilateral in nature the market remains. All must however operate under common principles of fairness and ethical behaviour.

Future trends

4.6 Technological developments and market evolution will assist in giving participants ever more choice of execution methods. The MPP notes that many market participants prefer the principal to principal current model of many wholesale FICC markets despite the potential conflicts of interest. However, the MPP recognises the importance of choice in underpinning a fair and effective market, and therefore encourages the development of agency-only order-matching alternatives where demand exists. Many agency-only models have been tried but they have seen limited success. The MPP recognises that the creation of effective ’order matching models‘ require collective and communal action between market participants to ’kick-start‘ such initiatives. This is the same with processing and settlement functions. There is a need for guidance / consensus-building forums to bring market participants together to create alternatives to the current status quo and therefore provide more choice.

4.7 It is inevitable that further regulation or imposed market structures could create cost and infrastructure barriers to entry. FICC markets naturally favour concentration on the sell-side, as was noted in the consultation document but there have been new entrants, and market concentration levels so far have not resulted in lack of supply choice in a fiercely competitive market.

Question 05 – Market microstructure – specifically Fixed Income

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?

Possibility of electronic trading

5.1 The MPP considers that a greater use of electronic trading for a wider range of market participants is possible and there is already a strong trend towards the growth in electronic trading, with existing regulatory initiatives accelerating this trend.

5.2 Electronic trading has significant market penetration in the more liquid fixed income products, such as Futures (~90% market penetration), CDS Index (~70%), US Treasuries (~55%) and EU Government Bonds (~45%), but is less developed in other areas (e.g. swaps, options and structured products). Over the past two years there have been many efforts to promote a greater use of electronic trading venues in credit markets, instigated by both buy-side and sell-side firms often facilitating all-to-all trading. Significant investment has also come from private equity financing, which sees this as a significant growth market. These trading platforms have been set up in relation to products that are likely to be mandatorily traded on a platform (OTC derivatives) as well as other products such as corporate bonds. Around 18 platforms have been launched or are due to be launched in the next year for the trading of corporate bonds. These efforts are at an early stage and have had mixed success, with issues arising in two areas: (1) low trading volume, and (2) difficulties in matching buy-side to buy-side orders. For all-to-all electronic trading venues to achieve sufficient liquidity to become truly viable requires a critical mass of users and bonds. Some areas of credit trading are inherently illiquid with individual bonds turning over infrequently, meaning that achieving widespread electronic trading will be challenging.

5.3 To date, it appears that the bespoke and heterogeneous nature of credit markets means that much of the electronic trading will be on a Request For Quote (RFQ) basis rather than a Central Limit Order Book (CLOB) basis. For example, in the US market, efforts have been made to make index CDS trading available on both a CLOB and RFQ basis and liquidity has naturally been drawn to the RFQ model. This reflects the nature of the product, and, for a predominantly institutional participant base, strikes the right balance between transparency and liquidity. ESMA has proposed that two of the most liquid CDS indices[13] in Europe be subject to mandatory clearing, with criteria defined for ongoing review of other indices and single name

[13] http://www.esma.europa.eu/consultation/Consultation-paper-Clearing-Obligation-no2-CDS

CDS. While the MPP supports the restriction of mandatory clearing to suitably liquid instruments, there remains a risk that regulation may cause dealers to move away from the market over time negatively impacting liquidity. The MPP supports further industry-led initiatives to assess the economic viability of central clearing across index and single name CDS to address this risk.

Desirability of electronic trading

5.4 Electronic trading brings a number of benefits, notably in terms of price transparency, improved operating efficiency and lower costs. In some instances electronic trading may also mitigate some conduct and conflict of interest issues by removing an element of human discretion. It could also make it easier to monitor markets and behaviour provided that algorithms and interfaces to electronic venues are supervised with the same level of rigour as human traders. An increase in the level of electronic trading on transparent all-to-all trading venues would, in the view of the majority of the MPP, increase overall fairness and effectiveness in liquid markets.

5.5 However, many on the MPP raised concerns that in less liquid markets, electronic venues can create a false perception of liquidity; that is, there appear to be prices, but they disappear when trying to transact on them, resulting in price slippage or worse, trade failure. Practices such as flashing prices and market scalping are a particular risk on electronic venues. This could create an environment in which it is harder for participants to navigate the markets (for instance they may need to invest in algorithmic trading capabilities themselves, or pay a bank for these services), and which could harm end-users due to limited liquidity and increased volatility.

5.6 The MPP is also concerned that electronic trading in vanilla markets, particularly CLOB methodologies, has led to a race amongst participants to invest in technology in order to gain marginal speed advantages. The costs involved in developing and maintaining this technology risk introducing barriers to entry and scale economies that may result in an imbalanced playing field with fewer participants able to compete meaningfully. The MPP would favour efforts to reduce the impact of barriers to entry arising from the scale and cost of technology. Potential mechanisms for some asset classes include a ‘heartbeat’ matching execution mechanism, (where orders are matched at pre-determined intervals, e.g. every 10 milliseconds) or the ‘speed bump’ mechanism that has gained some traction in equity markets. This would help to reduce the investment required to compete on electronic venues and limit the prevalence of low-latency predatory trading behaviours.

5.7 Given that there are inherent issues associated with both voice and electronic trading, the MPP considers that it is important that market participants continue to have flexibility to choose which channel they wish to trade through. Allowing this flexibility, gives participants the ability to make their own assessment of the benefits and issues associated with both electronic and voice trading.

Barriers preventing a shift to a more transparent market structure

5.8 The primary barrier to additional transparency is likely to be the need to preserve liquidity in the market. High levels of transparency applied to large-sized, illiquid positions would automatically result in an unwillingness of other market participants to take on that risk, and hence will diminish liquidity.

5.9 The MPP believes that the introduction of MiFID II / MiFIR has the potential to make the market more transparent, particularly for less liquid products such as corporate bonds, and that wider availability of data could help participants to gauge the 'fair' price for, and / or depth of interest in, a given instrument. However, there is still considerable uncertainty as to the full impact of the regulation. This is expected to become clearer when the European Commission issues the Level 2 Measures following the delivery of technical advice by the European Securities and Markets Authority (ESMA). Both incoming regulation and recent market efforts to move the trading of corporate bonds to electronic venues should be given the time to mature before further regulatory actions are taken. The MPP would urge regulators to exercise caution in the calibration of the pre- and post-trade transparency requirements of MiFID II / MiFIR, as well as the definition of a liquid market, to ensure that liquidity is not further diminished as a result of this process. For example, one member of the MPP raised concerns that the approach employed by ESMA in its technical advice is too high-level and would classify some non-liquid assets as liquid (under ESMA's proposals 42% of EU sovereign bonds and 67% of financial sector senior corporate bonds classified as liquid would not meet ESMA's own liquidity classification[14]). This MPP member would favour the calibration of liquidity thresholds using granular, dynamic measures.

[14] Table 5, p104 of the ESMA MiFID II / MiFIR Consultation Paper – 19 December, 2014 – ESMA/2014/1570

Question 06 – Market microstructure – specifically Fixed Income

Is standardisation of corporate bond issuance possible or desirable?
Should standardisation be contemplated across a broader range of fixed income products?
How could that be brought about?

Standardisation of corporate bonds

6.1 The aim of bond issuance is to provide issuers with a funding profile to match their requirements and to provide investors with assets that meet their investment requirements. The evolution of the corporate bond market has facilitated the creation of bespoke bonds to match the exact needs of issuers. There has been sufficient demand from investors for these bespoke bonds such that there has been very little pressure on issuers to conform to issuing standardised corporate bonds. For the standardisation of corporate bonds to be desirable for issuers, there need to be tangible benefits arising from standardisation, such as lower yields versus bespoke bonds. This is the model that has been adopted successfully by some of the 'frequent issuer' borrowers, such as the mortgage agencies in the US, or national governments.

6.2 Standardisation is a concept that has multiple components to it, including:

- Documentation;
- Issuance amount;
- Issuance dates;
- Maturity dates;
- Tenors;
- Coupon dates;
- Ability to buy back;
- Ability to re-open old issues;
- Issuance process.

6.3 Each of these is covered in turn below, but the overall view of the MPP is that issuers should have choice regarding the profile of their bonds. If there is an advantage for issuers to standardise bonds, for example lower spreads, then it should naturally evolve through market forces rather than by being mandated. Large issuers already have significant leeway to manage their liabilities in a way that encourages secondary market liquidity and produces lower funding costs, and more sophisticated issuers are sensitive to the need to have a liquid yield curve for their bonds and bonds with sufficient size to encourage or facilitate secondary market liquidity (although as noted below, large does not always mean more liquid). Moreover, there are considerable legal and practical difficulties in making any such proposal mandatory.

6.4 Nevertheless, where there are impediments to standardisation of debt, these should be looked at and removed where possible. The MPP is supportive of standardisation of documentation and removal of barriers to bond buybacks and re-opening of old bond issues where possible. Mitigating these underlying difficulties would help issuers to manage their debt in a way that can improve secondary market liquidity.

6.5 Alongside this, the MPP would support wider efforts to educate issuers on the potential benefits and costs of bond standardisation, but further investigation is required to assess how such efforts could be supported by the industry. A minority of the MPP would additionally encourage regulators to consider further how best to promote standardisation within their mandate.

6.6 The use of a kite mark or some other certification to distinguish standard and non-standard bond issuances was discussed by the MPP but there were concerns that the introduction of a kite mark may be interpreted by the retail market as a mark of credit quality as opposed to standardised status, and could lead to future suitability or litigation issues.

Corporate bond documentation

6.7 There are possible benefits in standardising bond documentation by using a pre-determined format or by making standardised disclosures, including improving efficiency for both the issuance process and due diligence by investors. Listing authorities are already engaged in this task as part of implementing the EU Prospectus Directive[15]. However, the MPP notes that, despite the EU Prospectus Directive, listing authorities are often commercial enterprises competing for business and may resist measures that limit their ability to compete (both 'good competition' in terms of competition to produce well-designed and accessible prospectus standards and 'bad competition' in terms of a potential race to the bottom in standards of disclosure).

6.8 There are gaps in the way in which standards are being applied in different financial centres and this is

[15] EU Prospectus Directive, European Commission: http://ec.europa.eu/finance/securities/prospectus/index_en.htm

both suboptimal and at odds with the European Commission's aspiration for a single Capital Markets Union.

Issuance amount

6.9 Standardisation of issuance amount, at least for one benchmark issuance per each annual point on the yield curve (e.g. $750MM tranches) may help drive liquidity in the secondary market as the 'free float' should in theory be larger. However, this would only be appropriate for large issuers. Mid-sized or smaller issuers would not have sufficient debt to issue $750MM per annual point, and attempts to reach standard size may lead to a lumpy and concentrated debt profile.

6.10 Issuers can already concentrate issuance into larger issues if considered beneficial and so further industry-wide initiatives are not required.

Issuance dates

6.11 Standard or pre-announced issuance dates aligned to quarterly dates may encourage manipulation of secondary markets ahead of the dates (similar to issues with benchmark fixings). Risks to issuance could also increase if there is insufficient investor demand, particularly if market conditions are poor on the relevant date. It is not recommended that industry or regulatory efforts are made to increase standardisation of issuance dates.

Maturity dates

6.12 There are significant risks associated with large-scale standardisation or alignment of maturity dates to specific points in time (e.g. quarterly dates). It may lead to bunching together of new issuance in anticipation of these dates, which could be exacerbated by blackout periods or temporary market 'closure' due to market conditions. This could lead to a large volume of refinancing concentrated into a short window of time, with increased risk of failed bond issuance.

6.13 While issuers should be free to choose maturity dates that align to standard hedging products (e.g. interest rate swaps) or issuance schedules, it is not recommended that industry or regulatory efforts are made to increase standardisation of maturity dates.

Tenors

6.14 Standardisation of tenors (e.g. by restricting the choice of tenor to a pre-defined list) would reduce the ability of issuers to match cashflow requirements and to optimise their investor base by issuing tenors that have strong demand (e.g. insurers seeking long-dated tenors to match long-dated liabilities). Issuers can already choose standard tenors if considered beneficial and so further industry-wide initiatives are not required.

Coupon dates

6.15 Alignment of coupon dates with standard hedging products such as interest rate swaps may deliver a slight hedging benefit for the issuer, eliminating any mismatch between the swap and the bond. However, this is not considered likely to help secondary market liquidity in any meaningful way.

6.16 Issuers can already choose standard coupon dates if considered beneficial and so further industry-wide initiatives are not required.

Ability to buy back

6.17 In principle, greater use of bond buybacks to retire old bonds and concentrate liquidity in a smaller number of remaining bonds is a sensible idea and is already used by many issuers. Issuers also have the right to include call options in a bond (at a cost to the issuer) to make it easier to use buybacks to manage their debt profile.

6.18 Some jurisdictional issues exist which restrict the ability of some investors to participate in buybacks (for example, conflicting UK and US tender offer rules lead some issuers to exclude US holders from participating in a tender offer that is conducted in accordance with UK tender offer rules). The MPP supports initiatives to remove such barriers but use of buybacks should remain voluntary and so standardising all bonds so that they can be bought-back should be avoided.

Ability to re-open old bond issuances

6.19 Re-opening old bond issues, rather than issuing new bonds, can be beneficial in terms of concentrating liquidity in fewer bonds or boosting size of older bonds. However, many factors may make this difficult, including:

- Tax language in a prospectus may change and prohibit bonds from being re-opened;
- An issuer may change their financial reporting such that it is inconsistent with re-opening old bonds;
- The issuing entity may undergo change as a result of M&A or a commercial decision, and outstanding debt may for commercial reasons not be novated (but could not be re-opened if the issuer wants to issue out of a different entity);
- The issuer may be downgraded from Investment Grade (IG) to High Yield (HY), impacting the type and severity of covenants that investors would seek, which would prevent re-opening the bond;
- The issuer may want to undertake a different type of borrowing not covered by their base document, (e.g. to issue out of a different entity, different structure, or in a different currency not covered by the base document);
- The issuer may not be able to comply with selling restrictions at a given point in time if rules have subsequently changed in that jurisdiction, impacting the way in which a deal is offered.

6.20 Buy-side and issuers would also need to accept bonds that are priced over or under their face value (over or under par value). Issuers typically prefer the simple accounting treatment of at par bonds. Investors can be nervous about bonds issued at a premium given insolvency payouts are typically capped at $100.

6.21 The MPP would support initiatives to remove barriers to re-opening bonds but recognise that several of the above barriers are likely to be difficult. It should remain voluntary for issuers to be able to re-open old issues.

Standardisation of corporate bond issuance processes

6.22 The MPP notes that in many Investment Grade (IG) issuances, the standard of prospectuses is generally higher than seen in High Yield (HY) issuances, and considers that there is a need to increase the rigour and professionalism in some HY issuances to bring them in line with the standards generally seen in IG issuances (acknowledging existing rules contained within the EU Prospectus Directive, see point 6.23). Similarly, in some cases the timing of a prospectus issue does not give analysts and investors sufficient time to review and reach informed decisions. Standardising both the timing and the content of prospectuses should ensure that appropriate disclosures are made in a timely manner, allowing the market to function with both more transparency and effectiveness.

6.23 The EU Prospectus Directive has introduced significant changes and progress has already been made in terms of quality of disclosures. Despite this being a ‘maximising directive’, there continue to be some variations in implementation across different jurisdictions that would be helpful to eliminate. Further industry guidance could support additional improvements and implementation of existing regulation.

6.24 Issues associated with allocations are covered in our response to Question 7.

Standardisation across a broader range of fixed income products

6.25 The MPP would prioritise the need to develop a robust standardised long-term alternative to LIBOR. The inherent issues with LIBOR are well publicised and the MPP believes the rates market microstructure would be more stable if a robust alternative was available. An alternative to consider for this is the Overnight Indexed Swap rate (OIS) as discussed in our response to Question 23, given the current emphasis towards cleared products.

6.26 A move towards a long-term alternative to LIBOR requires co-ordinated efforts because there is a disadvantage in being an early adopter of an alternative, given the lower levels of current liquidity when compared to LIBOR. The MPP is supportive of industry efforts to increase liquidity in alternative benchmarks but any transition should remain voluntary.

Question 07 – Market microstructure – specifically Fixed Income

Should the new issue process for bonds be made more transparent through the use of auction mechanisms, publication of allocations or some other route?

7.1 As discussed in our response to Question 6, the MPP suggests that additional industry guidance on the timing and the content of prospectuses for corporate bonds should be considered as a means of bringing additional transparency to the issuance process.

7.2 The new bond issuance process is multifaceted and must balance the needs of issuers with the needs of investors. Issuers have multiple objectives for their new issuance and seek the best overall terms for their transaction; price is just one of the elements they consider. Their other objectives may include targeting (or retaining) longer-term investors, investors that have a reputation for constructive engagement with issuers in workout situations, investors that have committed to be 'anchor' investors that enable a transaction to occur at all, or to target new investors in new markets or sectors to diversify their investor base. Given the issuers' right to select investors in order to meet their objectives, the process has long been one involving judgment and the regulatory framework has focused on the quality of dialogue and information flow between the issuer and its advisors to ensure these objectives are clearly articulated and executed on.

7.3 An auction-based mechanism could improve the price for the issuer, but may not lead to the best overall outcome as it mechanistically leads to the highest bidder winning, irrespective of whether they intend to sell on the bonds in the secondary market, lend them out to be shorted, or intend to be an obstructive participant in a workout situation. An auction-based mechanism may be more applicable at the liquid end of the spectrum and current processes regularly use a large number of elements of a Dutch auction as pricing moves from initial indication to final price and size. For this reason, the MPP considers that auctions may bring benefits for larger issuances in liquid, Investment Grade (IG) markets, but are neither suitable nor feasible for less liquid or High Yield (HY) issuances, and in all cases should be voluntary (for the issuer) to adopt. Indeed, auctions have been available at the choice of issuers for several decades. Liquid issuers can also benefit from using non-auction based approaches – for example the UK DMO conducted a consultation[16] on broadening distribution beyond auctions in 2008 and found syndication to be beneficial for a number of reasons.

[16] Supplementary Methods for Distributing Gilts: A Consultation Document, UK DMO, 17th December 2008:

7.4 Part of the role of a bookrunner is to ensure that the debt of a corporate ends up in the hands of responsible 'appropriate' investors. There is a risk that if an auction were held for HY issuances, the debt would end up in the hands of firms with divergent interests, running the risk of creating an unstable investor base where the interests of the issuer are not necessarily safeguarded. Across fixed income, moves towards increased use of auctions should be balanced against the requirement for issuers to have their bonds held by a suitable investor base.

7.5 The risk to perception of market fairness of non-auction based approaches is that certain investors, particularly smaller firms, may receive a smaller allocation than they would like. However, unless the right of issuers to select their investors is withdrawn, it is difficult to have an approach that would be considered fair by all investors.

7.6 Within the MPP there is a minority view that publication of allocations on an anonymised basis is one possible means to increase transparency of the new issuance process or of the allocation policy. However, detailed disclosure of allocations exposes confidential information about holdings to competitors of the issuer, dealers and investors, which may deter participation and undermine liquidity. An alternative to publication is to employ internal audit scrutiny of the syndicate process and the allocation logic, in order to enhance fairness and effectiveness. The MPP notes that some dealers do this already, but consistency across the industry would be helpful, and so recommends that this is adopted as an industry standard.

7.7 It is worth noting that the issuance process has been subject to regulatory scrutiny in the past and there have already been several consultations and industry efforts to improve the process, such as the 2005 ESMA consultation and the publication of the International Capital Markets Association (ICMA)[17] guidelines.

7.8 The MPP would also highlight a potential conflict of interest in the current government bond new issuance process. This is discussed in more detail in our response to Question 12.

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http://www.dmo.gov.uk/docs/publications/giltsmarket/consultationpapers/cons171208.pdf
Supplementary Methods for Distributing Gilts: Response to Consultation, UK DMO, 18th March 2009: http://www.dmo.gov.uk/docs/publications/giltsmarket/consultationpapers/cons20090318.pdf

[17] ICMA guidelines: http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Primary-Markets/ipma-handbook-home/

Question 08 – Market microstructure – specifically Foreign Exchange

Are there risks associated with internalisation and last look practices?

Are there barriers preventing increased pre- and post-trade transparency in foreign exchange markets?

Internalisation

8.1 When discussing the risks associated with internalisation, it is important to distinguish between internalisation in principal markets and internalisation in agency markets. The view of the MPP is that the vast majority of FX transactions today occur on a principal basis, although agency execution also exists. The main risks associated with internalisation arise when a dealer is acting in an agency-type role:

8.1.1 There is a challenge for brokers / dealers to demonstrate best execution, and an increasing risk that they are unable to do so if the trade has been internalised since there is no established reference price in FX (such as a National Best Bid Offer), or a consolidated tape. However, market participants are able to source multiple prices from different single and multiple dealer platforms. Establishing a reference price or consolidated tape in FX would be complicated by the global nature of the product, which is traded simultaneously all around the world in many ways;

8.1.2 There is a risk that internalising a bid-offer spread from a client's limit order could be seen to be in conflict with showing that order to the market. To the extent that this is a concern, it is important that dealers disclose the market scenario under which the limit order will be executed from the dealer's inventory. Regarding stop-loss orders, clarity of the risk management procedures used by the dealer would also be beneficial to clients.

8.2 When a dealer is acting in a principal capacity, internalisation can allow more efficient execution, avoiding brokerage costs and 3rd party bid-offer spreads. Greater scale allows a greater degree of internalisation and so this has led to increased dealer concentration in some markets (e.g. G10 spot FX). The risk of concentration is discussed in our response to Questions 14.

8.3 It is also recognised that in some markets which generally operate a principal trading model there may be circumstances in which orders are accepted that create agency type duties, and in those circumstances firms will need to ensure they comply with those duties, which may include best execution. The MPP agrees that there has not been enough clarity as to when those circumstances might arise, and that there needs to be increased transparency between firms and clients to clarify what the implications of the chosen execution model are.

8.4 Acknowledging these risks, the MPP thinks that internalisation has enhanced the effectiveness of the market as a whole by allowing dealers to offer tighter bid-offer spreads and deeper liquidity where principal to principal or agent to principal quotations are required and is evidence of a well-functioning market. Agency platforms have access to quotations from these internalisation engines and there appears a clear choice emerging between agency platforms and principal counterpart offerings. There is no evidence that increased levels of internalisation have negatively impacted the quality of the market.

8.5 The MPP is aware that MiFID II will impose new best execution reporting requirements on dealers acting as systematic internalisers or who conduct agency business within an Organised Trading Facility (OTF) for some FX products. The MPP anticipates that these new requirements will help ensure that clients can be satisfied that dealers are acting in their best interests when acting in an agency role. The MPP is also aware of the FCA's current thematic review of best execution[18], which is causing firms to consider carefully the circumstances in which best execution should apply, and will likely result in increased transparency and clarity as to the basis on which firms are acting for or with clients.

8.6 While the MPP considers it important to maintain the benefits brought by internalisation, particularly under the principal model, the market would benefit from the provision of greater disclosures, particularly in areas where the agency model is used. Specifically:

- Active participant education of internalisation practices, with differentiation between internalisation under principal and agency models;
- Greater disclosure for 'dark pools' (where the order book is hidden until a trade is matched, which is not common in FX) and internalisers used on an agency basis (where dealers match offsetting interest from internal order books), on matching methodology and details of liquidity providers;
- Clearer delineation between agency platforms and principal platforms and the role played by dealers so that there is complete clarity in market participants' minds as to dealer roles and whether fiduciary duties are owed or not;
- Greater record keeping requirements in agency models to ensure that dealers can demonstrate to their clients, on request, that the client did not receive an inferior execution as a result of being

[18] FCA Thematic Review, TR14/13 – Best execution and payment for order flow, July 2014: http://www.fca.org.uk/news/tr14-13-best-execution-and-payment-for-order-flow

internalised.

Last look

8.7 Some MPP members have emphasised the benefits of last look practices to market efficiency (by providing market makers with an effective mechanism to manage both latency and counterparty credit risk), while recognising the concerns raised by market participants and regulators about the potential for them to be misused. Indeed, within the MPP while many members support the use of last look on specified venues, some on the MPP consider that it should be phased out, even at the risk of spreads widening, as last look is not a common practice on all markets. The MPP acknowledges the potential for abuse which needs to be prevented. Specifically the MPP identified two potential areas for misuse:

- Market makers displaying prices without an intention to trade, in order to gain information;
- Market makers only confirming trades that are ultimately beneficial to the market maker, rejecting other trades.

8.8 In order to mitigate the possibility of abuse occurring, the MPP recommends the development of FICC Codes and Standards and Guidelines, as recommended in our response to Question 29. For last look, guidelines would outline disclosures to be made to counterparties, such as explaining the market maker's last look privileges and the associated benefits and risks involved. Additionally, standards would define pre- and post-trade transparency, as well as the surveillance and control mechanisms market participants should have in place to ensure that potential abuses are identified and visible to participants. This disclosure would give clients the ability to choose the liquidity pools that best fit their needs. The MPP also recommends that last look practices should be subject to constant surveillance and review within firms. It should also be explored whether and how clients / end-users who conclude they might have been subject to abuse can escalate their concerns within firms and ultimately to the regulator.

Barriers to pre- and post-trade transparency

8.9 The introduction of Dodd-Frank, EMIR and MiFID II is expected to bring significant enhancements to both pre- and post-trade transparency across a wide range of FX products in what is already viewed as a relatively transparent market.

8.10 However, spot FX is not fully covered by incoming regulations. In the US, spot FX is not determined to be a Dodd-Frank swap and is therefore excluded from trade reporting obligations. In Europe, spot FX is not classed as a MiFID Financial Instrument and is therefore excluded from MiFID / MiFIR reporting obligations. Public post-trade information on spot FX transactions is excluded from public distribution in both the US and Europe.

8.11 That said, spot FX has been at the forefront of electronic trading advances, leading to a higher level of transparency than in many other markets. The growth of Multi-Dealer Platforms (MDPs) and software solutions to obtain prices from multiple sources (e.g. aggregation tools) has further enhanced pre-trade price transparency. As such, spot FX is already considered to be highly transparent, with many channels available for both professional and non-professional market participants, affording them real-time access to market pricing.

8.12 The MPP currently supports the continuation of the exclusion of spot FX from trade reporting obligations. Any proposed changes would first require careful consideration of whether there are material benefits to subjecting spot FX to increased post-trade price transparency requirements, and whether such benefits would outweigh costs associated in doing so. Further evaluation should consider:

- Whether enhancing existing reporting (e.g. 6-month central bank and triennial BIS surveys), by increasing automation and harnessing existing reporting infrastructure is a viable approach to increasing post-trade transparency;
- Whether the real-time or aggregated (e.g. on a volume weighted average price (VWAP)) public dissemination of spot FX information for liquid products is needed and for what purpose;
- Feasibility of how such data might be captured and stored globally, across multiple time zones and platforms and whether a central time stamp could help dealers store / track data;
- Whether thresholds could be defined to increase transparency in the wholesale market without limiting the effectiveness of the transactional market.

Question 09 – Market microstructure – specifically Foreign Exchange

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

9.1 The MPP supports the recommendations made by the FSB Foreign Exchange Benchmarks Group[19], including support for the development of industry-led initiatives to create independent netting and execution facilities for transaction fix orders. The MPP agrees that such facilities could potentially help to enable end-users to transact at the fixing price while reducing potential conflicts of interest for dealers, increasing transparency and reducing market risk for participants. However, the MPP is cognisant of the challenges such facilities may face:

9.1.1 Handling residual risk: A netting facility would not be able to offer a risk absorption service to clients as the netted exposure (which will often be sizable) would need to be settled via an auction process or similar methodology. This may result in an imbalance between supply and demand through the fixing process, which could in turn result in a benchmark level being set away from where the market would otherwise be trading;

9.1.2 Increased costs, both in setting up these facilities and in potentially increased running costs, which may be a barrier to uptake of these new facilities by end-users. Additional investigation is required to ensure that markets are able to absorb this increased cost while remaining effective.

[19] Foreign Exchange Benchmarks, 30th September 2014 (Financial Stability Board – FSB): http://www.financialstabilityboard.org/wp-content/uploads/r_140930.pdf?page_moved=1

Question 10 – Market microstructure – specifically Commodities

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

10.1 Recent or in-train legislation, such as EMIR, MiFID II / MiFIR and Dodd-Frank, has increased minimum standards for pre- and post-trade transparency in commodities derivatives. Given the complex and fragmented nature of the commodities markets it is too early to ascertain the full effects of the regulatory changes but two main barriers in mandating further post-trade transparency have been identified:

10.1.1 Geographical regulatory arbitrage: The commodities markets are highly global in nature. Market participants may move trading to less regulated geographies as key participants seek to avoid the costs or impact on trading strategies of increased regulatory post-trade reporting requirements. The mitigant to this would be to ensure that any increases in regulatory requirements were implemented globally on a consistent basis (as discussed further in our response to Question 11);

10.1.2 Large trades in illiquid markets: Given the illiquidity and variable concentrations in markets for some commodities products any moves towards a more transparent market must take care not to drive large trades from thin markets or during periods of thin trading. The mitigant to this could be to either delay post-trade reporting or to make the information less granular to avoid giving away sensitive positions / trades (e.g. provide size buckets or aggregated amounts).

10.2 Pre-trade transparency, especially around derivatives, is seen as sufficient, with highly electronic inter-bank markets increasing ease of access and price transparency. Mandating additional pre-trade transparency risks diminishing liquidity. Ultimately, if end-user participants consider that there is not enough pre-trade transparency in the markets, it is likely that they will move towards alternative hedging techniques.

10.3 Pricing of physical commodities is significantly different to the conventional pricing of the OTC spot market. The quoted prices include premiums (i.e. costs of 999.99 / large gold bars), shipping and storage charges, taxes and duties.

10.4 The MPP considers that, given the settlement of physical commodities (post-trade) does not occur electronically, the potential role of automation is limited.

Question 11 – Market microstructure – specifically regulatory measures

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?

11.1 Effective markets facilitate efficient resource allocation and result in lower transaction costs, continuous trading flow and better price discovery. Many existing reforms, such as the Dodd-Frank act, EMIR, MIFID II, and MAD / MAR[20], are either being implemented or at early stages (see Appendix A). Before further regulation might be considered to address perceived structural problems, it is important to take stock of what regulatory reform has already been implemented or is in progress, to assess its efficacy and, most importantly, to evaluate how the financial system is evolving.

11.2 In particular, it is important to understand how liquid and resilient financial markets can help issuers and investors make transactions, transfer risk and channel savings to investments in a reliable way and without the uncertainty of sudden closure. Accordingly, it is important to recognise the role of liquidity providers in such markets.

11.3 The MPP has identified areas where we consider there is potential for additional regulatory measures or regulatory support:

11.3.1 Increased efforts to harmonise regulations across jurisdictions: As stated, with FICC wholesale markets being global in nature, the differences in regulations across various jurisdictions (e.g. CRD IV versus Fed leverage ratio requirements, transparency and trade reporting requirements, Swap Execution Facility (SEF) requirements) may lead to an un-level playing field and encourage differences in market behaviour between jurisdictions. The potential for regulatory arbitrage arising from these differences should be addressed by concerted efforts towards regulatory co-operation and convergence across jurisdictions;

11.3.2 Support the development of industry-led market-wide business conduct, standards and guidelines: The MPP recommends the development of industry-led, eventually international, FICC Codes and Standards, Guidelines and Case Studies but notes that regulatory support is likely to be necessary to drive adoption and relevance. Such support could include regulatory involvement in the development of FICC Codes, Standards and Guidelines; with key regulators providing their endorsement. More detail is provided in our response to Question 29.

[20] Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (market abuse directive): to http://ec.europa.eu/finance/securities/abuse/index_en.htmn

11.4 Priority areas for development of such detailed Guidelines include:

11.4.1 Definition and use of non-public information: There is currently a lack of clarity in the market on the appropriate use of both client and proprietary data; in the extent to which it can be used internally; and how it can be communicated externally. A clearer definition of how this information may be used would enhance market confidence, fairness and effectiveness. To the extent that 'grey areas' exist, the MPP recommends that additional clarification be provided around information use. Such clarification could either be achieved directly through regulation, or through industry-led FICC Codes, Standards and Guidelines which would ideally be endorsed by regulators. While it is acknowledged that judgement is required in determining appropriate use of non-public information, the MPP believes that additional guidance should be available to define the 'material' element of material non-public information (MNPI). This would provide market participants with more certainty on when they can and cannot use non-public information;

11.4.2 Market-wide end-user suitability standards: There is currently a lack of a consistent wholesale FICC market-wide standard for assessing end-user suitability when transacting in different products, with dealers and firms using their own judgment in determining an end-user's suitability to transact. This leaves scope for interpretation and the application of different standards by different dealers / firms, and runs the risk of participants being sold products that might not be suitable in a wider context. The MPP supports an industry-led definition of more granular market-wide standards of end-user suitability, but as with the business conduct standards, regulator engagement or input during their development would assist in ensuring such suitability standards are taken up;

11.4.3 Classification and terminology: The MPP believes that international agreement on terminology is required. Although some progress has been made and there is better communication internationally, there remain significant differences. For example, the definitions of material non-public information (MNPI), principal and agent, vary across geographies and markets. This confusion of terminology heightens the risk of misunderstanding of rules or of inadvertent governance lapse, and makes the cost and complexity of policing difficult. The MPP recommends that consistent terminology and language should be developed by the industry, and if this is successful in bringing clarity, the industry should subsequently encourage adoption or endorsement by regulators. IOSCO could play an important global role here.

11.5 Expand post-trade transparency regulation in some physical commodities: The MPP believes that expanding post-trade transparency in some of the more liquid, standardised physical commodities (such as gold bullion trading) will benefit the effectiveness of these markets. Availability of post-trade reporting in these products would provide an understanding of liquidity, help to dispel some concerns over information abuse, work towards levelling the playing field and allow for more reliable benchmarks to be constructed. Therefore, the MPP recommends greater post-trade reporting and the publication of liquidity flows for these selected physical products. However, given the fact that MiFID II / MiFIR was designed for very different markets, we suggest that this may not be the best route to achieve such transparency, particularly given the impact such a move would have on both wholesale and retail participants.

Question 12 – Conflicts of interest and information flows

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?

Question 13 – Conflicts of interest and information flows

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?

Questions 12 and 13 have been answered together given the overlapping themes.

12.1 Conflicts of interest and information asymmetry are inherent aspects of markets. While it is desirable to reduce conflicts of interest and information asymmetry where possible and necessary to manage any remaining issues, it is noted that it is not feasible to remove these aspects entirely. Accordingly, the MPP recommends that changes in this area should focus on conduct and business standards, rather than changes to market structure. Potential conflicts of interest are discussed below:

Principal role of dealers

12.2 The majority of FICC markets involve dealers acting in a principal role, with agency roles remaining a minority. A principal role brings an inherent conflict of interest between a dealer and their client, as the dealer may continue to hold the other side of the trade entered into by their client. In such a situation, the dealer would consequently profit from their client's loss. However, there is good argument that a fair and effective market exists where there is disclosure of the role a dealer is playing in a transaction and end-users have a clear understanding between:

- An agency execution model with fiduciary protection (including best execution) but less surety of price and execution;
- A principal execution model with higher certainty of price and execution but no fiduciary care is owed beyond normal integrity of conduct.

12.3 As noted in paragraph 8.3, the MPP accepts that agency-type duties can arise where the basic trading model is that of principal, and that there is therefore a need for clarity as to when those circumstances might arise, with appropriate disclosures to clients.

12.4 Where clear understanding exists, each participant can choose the best route for their particular risk tolerance and expertise in any FICC market. A corporate treasurer surrounded by screens and data may be more effective in principal to principal dealing in an FX or credit market, but still opt for agency dealing in a commodities or credit market.

12.5 To reduce the risk of participants being unclear as to which role the dealer is taking in any given transaction, the MPP suggests that pre-defined disclosures and consistent terminology are used to establish and communicate the role a dealer plays in a given transaction with different terminology around pricing.

12.6 Beyond this, efforts could be made to prevent all communication (including electronic) between principal and agency functions and potentially physical separation. However, where individuals act in both capacities this would clearly be impractical and so guidelines and surveillance are the primary means to manage potential conflicts.

12.7 The potential conflict of interest for dealers in a principal role can increase for products with pre-defined end / fix points or triggers, such as benchmark-related transactions or barrier options. Additional issues for these products are discussed in our responses to Question 3 and Question 4.

Use of non-public information

12.8 FICC market participants make a commercial return not just on bid-offer spread crossing. Few dealers are simply internalisers with sufficient volume and bid-offer crossing to justify the trading operations they support. Many make additional returns out of risk management and positioning to take advantage of their privileged position in market flows. As a principal, not an agent, the use of this information to position the firm is widely recognised as valuable. Many FICC desks described the value of seeing the market flows in performing their roles. There is clearly a fine line between a market-maker using its capital to take on and sell risk based on valid market intelligence received, and a central participant using non-public information to trade for advantage.

12.9 Further clarity should be provided to identify what constitutes material non-public information (MNPI) to reduce 'grey areas' in how non-public information can or should be used and on standards around conflicts of interest. Once these aspects have been clarified, information controls are needed to manage potential conflicts of interest.

12.10 A minority of the MPP believe that dealers should publicise their policies on the use of client information. Whether these are published or not, end-users can also drive change through including more specific non-disclosure agreements with dealers to control what information can be used by the dealer.

12.11 There also needs to be a cultural shift by all market participants, encouraged by regulators, to increase levels of reporting of suspicious or inappropriate behaviour. This is discussed in more detail in our response to Question 41.

12.12 In the commodities markets, vertically integrated firms may possess non-public information about price movement and market conditions from their own business. Acting on this information may be essential in the normal conduct of business activities, for instance, hedging price risks in light of supply disruption. However, firms may seek to leverage their position in the physical market to achieve excessive profits in wholesale financial markets. The ability to leverage such positions is diminished in larger or more liquid markets (e.g. Oil), but creates potential conflicts in smaller or less liquid markets. The ambiguity of these very different uses of proprietary information and the challenges of determining precisely what constitutes MNPI in commodities is exacerbated by the relatively high price volatilities naturally occurring in these markets. This can render conventional inside information approaches, such as those in equity markets, very challenging to apply. Care should be taken in defining MNPI so as not to unintentionally force vertically integrated firms to take on more risk (i.e. if information related to a firm's production volumes was to be considered MNPI and was therefore ring-fenced from the individuals responsible for hedging price-related risks in the market).

Dealer incentives to maintain primary dealer status in the rates market

12.13 Governments and their debt management offices (DMOs) award primary dealers 'status to deal' based on the concept of primary dealer scoring. A component of the primary dealer scoring is a dealer's willingness and evidence of them supporting the secondary trading of bonds. The Treasury framework for awarding a dealer primary dealer status is therefore tied to a dealer's secondary trading activity. While dealer access to secondary markets helps price new issuances effectively, reflecting issuer and investor risk appetite and demand, the linkage could also create a conflict of interest where dealers may be incentivised to engage in loss-making behaviour in the secondary market to maintain their primary dealer status.

12.14 The onus on resolving potential conflicts of dealers maintaining primary dealer status should be shared between market participants and issuing sovereigns. The present conflicts of interest often derive from issuer-led scoring systems, which can be enshrined in law. Dealers should work with sovereign issuers to assess and address unintended conflicts arising from primary dealer scoring mechanisms. As part of this, issuers need to ensure that the role of primary dealers is clear and that primary dealer scoring systems are aligned with this role.

Cross-subsidisation

12.15 This is discussed in our response to Question 4.

Allocation of bond issuance to investors in fixed income markets

12.16 This is discussed in our response to Question 7.

Best execution monitoring

12.17 Once a fiduciary responsibility is taken on by a desk for any particular order, its monitoring needs to be carefully evidenced so as not to expose the dealer to hindsight evaluation of perceived poor execution or conflicts of interests. Traders should remain the first line of defence against fraud and misconduct, but best execution monitoring must also be reviewed and confirmed by a party independent from the front office.

Access to closed liquidity pools

12.18 There is a potential conflict of interest around having closed liquidity pools, which exclude certain market participants. However, in some cases they aid market effectiveness. For example, the ability of sell-side participants to provide liquidity in inter-dealer pools would be compromised if opportunistic high frequency participants were added to these pools. In order to mitigate potential conflicts it is critical that trading venues are able to assess transparently and objectively the impact to liquidity of adding participants and make an informed decision on whether (and what types of) new members should be added.

Section 2 – Competition & Market Discipline

Question 14 – General

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.

14.1 The MPP is of the opinion that there is no intrinsic relationship between the level of competition in FICC markets globally and the fairness and effectiveness of those markets. Competition is important to fairness and effectiveness, but is not the only factor at play. FICC markets are generally considered to be highly competitive and effective, with the main challenges sitting with establishing fairness in the markets, which require further protections as discussed elsewhere in this consultation response.

14.2 An increase in concentration in FICC markets has predominantly been seen in markets that are highly commoditised (for example FX). Within these markets, this phenomenon is not considered by market participants to cause any undue risks to fairness and effectiveness with the exception of the tail risk associated with the failure of a counterparty.

14.3 Given the intense competition still experienced in FICC markets, the MPP does not consider that further regulation is required to stimulate competition, however, the MPP would not wish to pre-empt findings from the FCA Wholesale Sector competition review[21].

14.4 Since the FICC markets are global, extra-territorial regulation can have a strong impact on competition in both the UK and international markets. The initiatives of the FSB and IOSCO to harmonise standards are broadly welcomed. However, an inconsistent application of these standards could cause exchanges and market participants to move out of the EU, which would obviously be bad for all. Inefficient cross-border regulation can fragment markets and liquidity and reduce competition, as has happened with derivatives due to a lack of recognition between the Dodd-Frank and EMIR[22] frameworks. Markets which do not receive equivalence / substituted compliance determinations will be at a long-term

[21] FCA Wholesale Sector Competition Review, July 2014: http://www.fca.org.uk/static/documents/market-studies/wholesale-sector-competition-review-call-for-inputs.pdf

[22] European Markets Infrastructure Regulation (EMIR): http://www.esma.europa.eu/page/post-trading

competitive disadvantage, most likely resulting in their effectiveness declining as well.

Question 15 – Promoting effective competition through market forces

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?

15.1 FICC markets are considered highly competitive and effective, but the main concerns arise with regard to the fairness of those markets, which leads to the need for a further raising of standards as discussed elsewhere in this consultation response. In that context and in answer to this question, discussions within the MPP highlight two areas for possible consideration:

Electronic trading

15.2 The changing role of banks in the global FICC markets should encourage the development of the agency brokerage model. Crossing networks are beginning to emerge, primarily for smaller, order-driven trades, which should help smaller firms access the market. Platforms provide ready prices for the lesser amounts that such firms are looking to trade, so long as the products exchanged are liquid / more standardised. This includes the currency markets, which are already highly automated and offer a generic product with low bid-offer spreads (for liquid pairs).

15.3 In FICC markets it should be noted that firms can still need the services of an intermediary. These firms do not want to advertise their trading strategy to the competition and need a trusted third party to connect them to an interested counterparty. In this respect, electronic matching platforms have not been successful to date, though opinions vary as to the ability of such platforms to develop in the future (albeit for liquid products only). Given that such platforms are still in their early stages of development, it is currently difficult to foresee exactly how they will evolve or to suggest interventions.

15.4 In the current interest rate environment where demand for yielding investments has grown, it is difficult to speculate on the reasons for the slow take-up of electronic platforms. This will be an area to keep under close observation as interest rates normalise.

15.5 It is important to note that electronic trading does not completely eliminate conflicts of interest. Potential issues can still arise from last look practices, incentives to maximise rebates for high volume execution and incentives to maximise execution fees. These are discussed in more detail in our response to Question 5.

	Cross-subsidisation
15.6	This is discussed in our response to Question 4

Question 16 – Promoting effective competition through market forces

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?

16.1 While it is useful to look for lessons from other markets, it is important to recognise that a blueprint from one market cannot always be transposed directly on to another. It is superficially compelling to draw parallels between the equities and FICC markets; however, the MPP did not consider this was an appropriate comparison.

16.2 Participants in FICC markets are generally wholesale firms, some of whom are acting on behalf of an end-investor, whereas there is a much higher percentage of direct participation by retail investors in equity markets. The professional nature of FICC counterparties and their experience in the markets has allowed them to become accustomed to varying levels of liquidity. The MPP therefore does not consider that it is a desirable or even feasible outcome to try to impose continuous liquidity across all market segments.

16.3 One suggestion that has emerged in the MPP is to consider limiting the number of bookrunners for new bond issues to one or two firms, as is the case in the US. Some buy-side market participants, particularly those of a smaller size, feel that multiple bookrunners for new issues may result in less competition and accountability. In addition, when questions are posed regarding the rationale behind allocation, having four or five bookrunners can make it easier to shift the responsibility for an allocation decision to another party. This view is not fully shared across the MPP and the pros and cons of such a shift would need to be evaluated more thoroughly with wider industry engagement prior to any recommendation. In addition, several buy-side market participants have expressed a preference for issuers to be more involved in the allocation of bonds to investors.

Question 17 – Promoting effective competition through market forces

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

17.1 Professional counterparties who feel that their interests have been harmed have resorted to differing methods to impose market discipline, in a fashion that is generally proportionate to the perceived offence. Remedies include stopping trading with a counterparty across all products, limiting order flow to a given counterparty within best execution limits and / or complaining to senior management. In addition, it was highlighted that counterparties would take into consideration behaviours of that firm that were deemed to have a negative reputational impact, particularly in the case of corporate end-users, although this is likely to be more effective for larger rather than smaller corporates due to their business volume.

Existing tools for market discipline should be strengthened and publicised

17.2 Although methods to impose market discipline already exist and are used, further (non-regulatory) improvements could be made in order to attain a desired 'culture of escalation'. Several MPP members mentioned that anonymous tip lines could be provided on an EU-wide basis, or at least within each EU country. When polled at an industry conference, only one firm from a set of twenty was aware that the FCA's Market Conduct Team accepts anonymous calls on market conduct issues. The existence of this hotline should be more widely promoted and it was suggested that broker internal whistleblowing lines could potentially be opened to external parties.

17.3 The SEC's Office of the Whistleblower[23] was considered, and the ability for informants to share in the fines imposed was cited as a strong potential incentive for people to come forward. However, as noted in our response to Question 41 paragraph 41.8, this runs counter to developing a culture of accountability, and an internal reward approach would be better aligned to championing behaviours and standards and to establishing positive incentives. This echoes the findings of a joint PRA / FCA note[24] to the Treasury Select Committee published in July 2014.

[23] SEC's Office of the Whistleblower: https://www.sec.gov/whistleblower

[24] http://www.fca.org.uk/news/financial-incentives-for-whistleblowers

Specific to Euro credit

17.4 Given the geographically diffuse nature of investors in Euro credit, market discipline was perceived to be less effective. In order to improve market discipline, the suggestion was made to (perhaps with the volume masked) set up a semi-public database of bond holders or publish holders of new corporate bond issues. These investor lists could facilitate the organisation of EU-wide Special Committees. Such Committees could be modelled on the ones run in the UK, which provide bondholders with an appropriate forum to discuss problems with issuers and brokers.

Specific to fixes and benchmarks

17.5 The MPP agrees that better conflict management and controls over client information are needed, especially in relation to fixes and benchmarks. This is discussed in greater detail in our response to Question 12 (conflicts) and Questions 21 - 26 (benchmarks).

Question 18 – Promoting effective competition through regulatory and legislative initiatives
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)?

Question 19 – Promoting effective competition through regulatory and legislative initiatives
Are there any additional regulatory reforms that could be helpful in promoting competition and market discipline in FICC markets?

Question 20 - Promoting effective competition through regulatory and legislative initiatives
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?

The Group has addressed questions 18, 19 and 20 together given the interdependence of the responses and recommendations offered.

Unintended consequences of systemic regulation

18.1 All market participants have a clear understanding of the prudential rationale behind recent systemic legislative initiatives (such as Basel III[25] and derivatives reform) aimed at improving the safety and soundness of markets. Inevitably this regulation was felt to have reduced competition across FICC market segments by setting up barriers to entry and restraining trade.

18.2 Capital requirements imposed on EU banks (CRD IV and CRR) have been the primary source of barriers to new entrants in FICC markets. Banks that act as principal are subject to a capital charge, meaning that new bank entrants are less likely to perform such trades ('risk-transfer trades') and instead prefer to act as agency brokers ('order-driven trades'). A similar movement has been seen in FX, where market participants work towards flat positions at the end of the day in order to avoid capital charges.

18.3 For commodities, the impact of this regulatory-driven behavioural shift by the banks has been more stark, since the major participants in commodity derivatives are now the corporates with a large presence in the physical market. Even though nearly all of these participants are undertaking transactions with ties to real economic as opposed to speculative purposes, changes to derivatives regulation have resulted in increased costs for such participants. At the same time, product standardisation of derivatives has resulted in an increase in their risk since the hedging cannot always be done exactly to meet the corporate's precise exposures (i.e. creating 'basis risk').

[25] Basel III (BIS – Bank for International Settlements): http://www.bis.org/bcbs/basel3.htm

Further regulatory change and competition authority intervention are at this time unlikely to improve competition

18.4 Banks may become more selective when offering products and trading to their clients across all FICC products. However, it is possible to foresee a shift by banks towards providing liquidity to higher revenue generators, though the remaining market participants may be able to benefit from liquidity offered by the concurrent development of electronic platforms.

18.5 The regulatory framework under which such platforms must operate is already defined in MiFIR, with rules on how an Organised Trading Facility (OTF) must function, and further requirements for Systematic Internalisers including mandatory pre- and post-trade transparency (subject to certain conditions). It is not yet clear what the impact these rules and requirements will have on market participant behaviour, market liquidity and competition, so consideration of any further broad-based regulatory change to the markets framework should happen once these effects are well known and understood.

18.6 Once the impact of regulation has been absorbed, and resulting availability of wholesale products and services is clearer, the question should be re-posed.

Section 3 – Benchmarks

Question 21 – General

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

21.1 Benchmarks are critically important to the effective functioning of FICC markets. There are many different types of benchmarks, used in different ways by a wide range of market participants.

21.2 The MPP recognises that significant work has gone into strengthening financial benchmarks. In particular the MPP supports the IOSCO principles for financial benchmarks[26] and feels that these principles, once adopted, will make benchmarks sufficiently robust. IOSCO provides an approach that reflects the diverse, global benchmark industry, with several large providers and millions of individually available benchmarks.

21.3 However, speed of implementation has been mixed across geographies and benchmarks. In the UK, benchmark regulation was introduced in March 2013 prior to the finalisation of the IOSCO Principles, although the only specified benchmark at that stage was LIBOR, leaving other benchmarks out of scope of regulation. Following the recent FEMR consultation, the FCA has confirmed that seven[27] other benchmarks will be included as specified benchmarks under UK regulation. Draft European regulation was initially proposed in 2013[28], with subsequent proposed revisions by the Presidency of the Council of the EU (September 2014) and European Parliament Committee on Economic and Monetary Affairs (December 2014). This regulation has not yet been finalised or implemented. Globally, IOSCO has stated that benchmark administrators should publish self-assessments against the IOSCO principles by July 2014, but this has not been completed by all administrators.

21.4 The MPP believes that the immediate priority should be to accelerate adoption of IOSCO principles globally. The MPP therefore supports the finalisation and implementation of benchmark-related regulation in countries and regions where benchmarks will be regulated, as a mechanism to drive implementation of

[26] IOSCO (International Organisation of Securities Commissions) Principles for Financial Benchmarks: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf

[27] FCA to regulated seven additional financial benchmarks, 22 December 2014: http://www.fca.org.uk/news/cp14-32-additional-benchmarks

[28] Proposal for a Regulation of the European Parliament and of the Council on induces used as benchmarks in financial instruments and financial contracts, European Commission, 18th September 2013: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52013PC0641&from=EN

the IOSCO principles, particularly for critical benchmarks. For countries not intending to regulate benchmarks (including the US), other mechanisms should be used to drive adoption of IOSCO principles, potentially including self-certification bolstered by independent assurance to ensure consistent levels of compliance. Any regulation should be consistent across jurisdictions in order to minimise the risk of regulatory arbitrage, while allowing for a proportionate and pragmatic approach both to implementation and to the recognition of third country regimes. Where benchmarks are regulated, the MPP supports the focus of regulation and supervision on critical benchmarks, where there would be major market disruption if such benchmarks were to be discontinued, while a more moderate and proportionate approach (e.g. self-certification) is appropriate for non-critical benchmarks. This is consistent with the current UK regulation for specified benchmarks and the latest European Parliament amendments to the European regulation.

21.5 The MPP commends the thorough consultation process carried out by the FSB on interest rate and FX benchmarks and fully endorses the recommendations in its final report[29].

21.6 The MPP does not consider that it is appropriate to create substantial additional new requirements for benchmark administrators or submitters before the effectiveness of current IOSCO principles and incoming regulation can be assessed. The MPP supports IOSCO's intention to carry out a review to assess the level of adoption and effectiveness of each principle and make any necessary amendments, planned for 2015.

21.7 IOSCO established a proportionate approach to its application by setting out 'uniform expectations' but avoiding a 'one-size-fits-all' method of implementation. The definition of financial benchmark included in the IOSCO principles is very broad and can be interpreted as including everything from major equity indices (e.g. FTSE 100) to niche commodity prices. As IOSCO principles and regulation are implemented, the different nature and application of benchmarks should be taken into account in order to ensure that the application of the principles should be proportionate to the size and risks posed by each benchmark and / or its administrator and benchmark-setting process. The MPP suggests that it would be useful to categorise benchmarks according to the nature of the inputs / underlying, in order to provide greater transparency to benchmark users. An example of a simple categorisation would be:

[29] Foreign Exchange Benchmarks, 30th September 2014 (Financial Stability Board – FSB): http://www.financialstabilityboard.org/wp-content/uploads/r_140930.pdf?page_moved=1

- Benchmarks based on prices from regulated venues;
- Benchmarks based primarily on prices of executed transactions or committed quotes, where the underlying is traded frequently;
- Benchmarks based on prices of underlying which is traded infrequently, with resulting greater reliance on expert judgement.

Of course, the same benchmark might migrate between some of these characteristics depending on market conditions / activity and any system would need to consider how to help users understand this.

21.8 One of the IOSCO principles relates to data sufficiency which requires benchmark administrators to ensure data used to construct a benchmark is accurate and reliable and anchored in an active market. In general, the more hard data points (e.g. trades or committed quotes) used to compile a benchmark, the more robust it is likely to be. However, it should be noted that such hard data does not guarantee a robust outcome and so it is critical that (potential) users are very clear what they are using. It would be helpful for benchmark administrators to publish metrics related to the liquidity in the underlying market to enable benchmark users to understand the nature of the inputs and make their own judgement on the robustness of the benchmark. Such metrics would need to be produced regularly and on an ongoing basis to reflect changes in markets over time. This will rely on submitters providing data on executed transactions to administrators or to a central data repository. Increased reporting of underlying transaction data will also enable improved surveillance by administrators to identify potentially erroneous or suspicious submissions.

21.9 The MPP recommends the creation of a global database of FICC benchmarks to support implementation of IOSCO and regulatory requirements and to increase the level of transparency to end-users. This database could potentially be extended to other asset classes outside the scope of this consultation. Such a database could be created either by the FSB or IOSCO, by an industry body or a commercial entity. Regulatory support may be required to drive adoption of the database and achieve critical mass in the short-term, but the MPP believes that the aim should be that the database is self-sustaining in the longer term and so could be run by an industry or commercial entity. The database would provide information for each benchmark or benchmark family, which could include:

- Administrator;
- Regulator;

- Level of IOSCO compliance – either based on self-assessment by the administrator or assessment by the regulator;
- Regulatory compliance (where applicable);
- Nature of benchmark (e.g. based on data from regulated venues versus benchmark of illiquid underlying);
- Data on liquidity of underlying;
- Level of usage (ideally including data on volume and value of transactions referencing the benchmark, to the extent available);
- Date of information update.

21.10 The above database would go beyond the ESMA register of administrators[30] included in the draft European regulation, which is proposed to include only the names of registered administrators. The MPP acknowledges that the data required to complete the database may be challenging to acquire (in particular data on benchmark usage), but feels that completion to the greatest extent possible would provide end-users improved information to judge the relative suitability and reliability of benchmarks against their needs.

21.11 A major current concern is the level of participation in some benchmarks, which could come under further pressure as regulation is implemented. The broader the participation in benchmark setting, the more relevant and less prone to manipulation benchmarks become. However, real or perceived conduct and reputational risks associated with participation in benchmarks, combined with the increased cost of complying with regulatory requirements or submitter codes of conduct, provide a major disincentive to submit information to benchmark providers or to participate in benchmark-setting venues. This is particularly the case for benchmarks for certain niche or less liquid asset classes, such as commodities, where the specific nature of underlying products and the limited transaction volumes mean that benchmarks are often reliant on incomplete or subjective information. Recent legislation widening the scope of criminal prosecution of benchmark manipulation in the UK increases this disincentive. If participation declines further, or the cost of full IOSCO compliance to either the administrator or submitters becomes unmanageable, there is a risk that some benchmarks could be discontinued.

[30] ESMA-EBA Principle for Benchmark-Setting Processes in the EU, 6 June 2013: http://www.esma.europa.eu/system/files/2013-659_esma-eba_principles_for_benchmark-setting_processes_in_the_eu.pdf

21.12 There is consensus that all necessary measures need to be taken to ensure continuation and availability of critical benchmarks, at least until viable alternatives and realistic transition plans can be established. The proposed two-tier approach in the European regulation should reduce the compliance cost for non-critical benchmarks, supporting continuation. For critical benchmarks, the proposed mandatory contribution by supervised entities should ensure temporary continuation, although is not seen as an attractive permanent solution.

21.13 There are mixed views in the MPP on non-critical benchmarks of illiquid underlyings. Some believe that discontinuation would lead to a reduction in the fairness and effectiveness of the FICC markets, due to the market disruption for participants holding financial instruments that reference such benchmarks and the decreased market transparency on an ongoing basis. Others believe that it is not necessary or appropriate to continue a benchmark of an illiquid underlying market and so such benchmarks should be allowed to be discontinued, once appropriate measures are in place to manage any market impact.

21.14 It is acknowledged that the cost and risk of being a benchmark administrator has increased, which will inevitably require costs to be passed on to end-users through increased pricing for access to or use of the benchmark. Given the inevitable concentration on a small number of benchmarks in each asset class, combined with the difficulty in transition from one benchmark to another, the MPP believes that controls over pricing levels for the use of critical or systemically important benchmarks should be part of the regulatory framework to prevent excessive price increases which would negatively impact fair access to market information. There should also be regulatory controls over availability of critical benchmarks to market participants, to avoid market disruption if data is not available. An administrator should not be able to withhold critical, or systemically important, benchmark data from market participants as part of commercial negotiations.

21.15 Finally, the MPP acknowledges that there will remain residual risk for benchmark users. Legitimate trading of instruments underlying benchmarks could lead to unexpected (positive or negative) impacts for users and the possibility of manipulation cannot be entirely eliminated. Nevertheless, current initiatives and the recommendations laid out above are expected to reduce such risks considerably.

Question 22 – Industry level measures
What steps could be taken to reduce the reliance of asset managers and other investors on benchmarks?

22.1 Before discussing the reliance of asset managers and other investors on benchmarks, it is important to distinguish between different uses of benchmarks:

- Reference rate benchmarks are used to define payouts in financial instruments. For example, LIBOR is widely used as a reference rate in many loans, floating rate notes and derivatives;
- Performance benchmarks are used to measure the relative performance of an investment fund or managed account. For example, a fund may state that it is designed to outperform a given benchmark and will report returns relative to that benchmark;
- Price benchmarks are daily price references used to calculate fair value of a single financial instrument or position, such as a bond or commodity.

22.2 Some individual benchmarks may be used for more than one of the above applications. Across all applications, it is important that any benchmark is robust and free from manipulation. The level of reliance for each application is discussed below, along with the MPP's view on whether or not it would be beneficial to reduce reliance and, if so, how that might be achieved.

22.3 Importantly, the use of benchmarks by asset managers is inextricably linked to the use of benchmarks by the asset owners (or end-investors) for whom they manage assets.

Reference rate benchmarks

22.4 Asset managers and other investors are reliant on reference rate benchmarks to the extent that they use financial instruments which reference such rates. For example, asset managers and investors may invest / transact in floating rate notes or interest rate swaps which reference LIBOR. This reliance is exactly the same as for other market participants using similar products.

22.5 Any restriction in usage of products which include reference rate benchmarks would constrain the available investment or hedging strategies and is not supported by the MPP.

22.6 One situation where restrictions may be necessary is in the event of a market-wide transition away from a benchmark, if it is considered insufficiently robust or unsustainable. However, this would involve laborious and expensive re-writing of financial contracts and so should be avoided if at all possible. Any transition strategies should apply to all market participants and be sufficiently long to account for the required changes to documentation.

Performance benchmarks

22.7 Performance benchmarks are used widely to assess investment performance, particularly for equity investments, but also for investments in FICC asset classes. End-investors are typically more dependent than asset managers, using benchmarks to support measurement of relative fund (and asset manager) performance and to define the investment universe in which asset managers can invest. In these cases, fund / asset managers typically define the appropriate benchmarks, but end-investors can specify alternatives. In the case of pension funds, investment consultants often use benchmarks for performance analysis and manager rotation. They are also heavily used by sovereign wealth funds in managing the risk of overall portfolios allocated to multiple carve-out managers. The benchmarks provide a 'market average' reference to allow over- or under-performance to be measured more easily than using absolute returns, and create accountability for asset managers.

22.8 Benchmarks are further used as a basis for performance fees to closely align manager and client interests as well as promoting lower base fees.

22.9 It is noted that strong focus on indices can skew investment towards assets captured by the benchmark, which may give a liquidity advantage to issuers whose bonds are included in benchmark.

22.10 Overall the MPP believes that performance benchmarks are an important tool and should not be unnecessarily constrained.

Price benchmarks

22.11 Daily price benchmarks are used to calculate fair value of financial instruments or positions (e.g. Gold Fix, FX Fix) and are regularly used by asset managers and end-investors to calculate fair value of assets within the portfolio. The MPP does not support measures to reduce asset managers' reliance on benchmarks for this application.

22.12	Overall, the MPP does not support restriction of benchmarks or the prohibition of different uses by asset managers or other market participants. Rather, the MPP strongly supports the adoption of benchmark best practices by administrators and transparency so there is clarity around what a benchmark is and so how it is likely to behave. Provided that this transparency is in place, the decision to use a benchmark should be at the participant's own risk.

Question 23 – Industry level measures

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

23.1 The MPP favours the upgrades to the design, construction and governance of benchmarks laid out by IOSCO and therefore supports efforts to accelerate and enforce adoption of its principles, as highlighted in our response to Question 21.

23.2 However, it is noted that the challenge is how to monitor compliance with IOSCO principles once adopted. The robustness of benchmarks is likely to change as markets evolve, and therefore surveillance needs to be continuous. If administrators seek independent assurance over their IOSCO compliance statements, compliance with the IOSCO principles will be effectively monitored.

23.3 For liquid products, the MPP supports migration away from judgemental submissions to the use of transaction data or committed and executable quotes from organised trading venues. In some cases, it may be possible to change the inputs and methodology without fundamentally altering the benchmark, which would avoid any need to change existing contracts. However, in other cases, a shift may need to be encouraged by regulators given the stickiness of benchmark usage by participants and end-users.

23.4 As discussed in in our response to Question 21, the MPP supports ongoing initiatives led by the FSB to strengthen interest rate benchmarks[31], in particular through development of 'IBOR +' methodologies and near-risk free rates (e.g. OIS or repo rates). It is important to recognise that it is the lack of actual transactions that provide a root cause of concerns related to LIBOR and other inter-bank interest rate benchmarks.

[31] Financial Stability Board (FSB), Reforming Major Interest Rate Benchmarks, July 2014: http://www.financialstabilityboard.org/wp-content/uploads/r_140722.pdf

Question 24 – Industry level measures

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

24.1 Strong industry engagement is important in developing and implementing any changes to the design or use of benchmarks, either through broad industry consultation or through engagement through an industry panel. For example, the FSB Market Participants Group[32] provided valuable input to the FSB study on reforming major interest rate benchmarks conducted during 2013 / 14. Several administrators also use industry panels to provide input and feedback when developing and implementing changes to the design of its benchmarks.

24.2 The MPP does not see the need for a permanent industry panel to assist industry transition, but supports ad hoc engagement of temporary industry groups to consult on any further changes. The level at which such a panel operates (i.e. globally, internationally or locally) would depend on the body developing the proposed change. Also, a panel should represent the specificities of a given market or asset class, given the differences in inputs, construction and use of benchmarks across markets and asset classes. Such a panel should be carefully formed to ensure that the voice of a broad group of market participants is heard, including corporates, small end-users, trading venues and brokers. The panel could include a combination of individual market participants and trade associations.

24.3 A benchmark industry working group could be helpful in the design and establishment of the database of benchmarks described previously.

[32] Market Participants Group on Reforming Interest Rate Benchmarks – Final Report, March 2014: http://www.financialstabilityboard.org/wp-content/uploads/r_140722b.pdf?page_moved=1

Question 25 – Regulatory action

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

25.1 As discussed in our response to Question 21, the MPP would like to see regulation of financial benchmarks finalised and implemented across jurisdictions where benchmarks are (to be) regulated, in order to enforce adoption of IOSCO principles on agreed timelines.

25.2 In addition, the recommended global database of FICC benchmarks discussed in our response to Question 21 could be created either by the official sector (e.g. FSB or IOSCO), an independent industry body or a commercial entity.

Question 26 – Regulatory action

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

26.1 As recommended in our response to Question 21, a global database of benchmarks including status of compliance with IOSCO principles and indications of liquidity of underlying instruments would enable market participants to check the robustness of foreign benchmarks and make their own decision on whether or not to use a specific benchmark.

26.2 Market participants favour consistent application of IOSCO principles across jurisdictions, which would provide similar comfort and understanding of the robustness of benchmarks from other jurisdictions. However, the MPP notes the different regulatory approaches currently being taken and the resulting difficulties in achieving equivalence. If equivalence is a pre-requisite for market participants to use benchmarks from other jurisdictions, this could create major market disruption. The MPP prefers transparency through the database described previously, rather than prohibiting the use of certain benchmarks. The MPP does not support 'third country' type provisions in terms of benchmark use, as currently proposed in the draft EU regulation.

Section 4 – Standards of Market Practice

Question 27 – General

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?

27.1 There are numerous sources of information regarding standards of market practice, including regulations, law, voluntary industry codes of conduct and firm-specific codes of conduct. However, it is evident that such information did not prevent the unacceptable market practices that have become apparent in recent years.

27.2 In the view of the MPP, this failure was driven by a combination of a lack of adoption and enforcement of available market standards (particularly in terms of adoption of high-level principles), and a lack of clarity of existing sources of information (such as detailed guidelines for trading around benchmark setting times). In some cases, information regarding standards of market practice was not fully reflected in firms' internal policies and procedures, was not effectively understood by firms' employees and was not enforced by firms. Compensation that was based largely on short-term revenue did not incentivise individuals to act in line with expected standards and bad behaviour was not systematically identified and penalised. Further views on accountability, incentives, surveillance and penalties are covered in our responses to Questions 36 to 49.

27.3 There are four main issues specifically relating to standards:

27.3.1 **Proliferation of codes:** Many worthy but uncoordinated attempts have been made to establish codes and principles. As a result, there are too many different codes, regulations and other sources of information across activities, asset classes, geographies and types of firm. These sources are not linked, creating a patchwork which is overlapping, sometimes contradictory, difficult to navigate and not fully consistent;

27.3.2 **Limited guidance on interpretation of standards:** In many cases the standards of market practice did not contain detailed practical guidance on specific activities. Guidance was either principle-based, relying on interpretation by firms or individuals, or focused on procedures or technical market issues rather than market practices. Limited detailed guidance was available from regulators or at the industry level and firms had mixed levels of success in terms of translating such codes into practical guidance. This left interpretation to individuals, and internal controls within firms were insufficient to identify all inappropriate interpretations;

27.3.3 **Insufficient communication of standards:** Firm-led communication of standards of market practice was not always adequate to ensure sufficient understanding by individuals. Firm-led employee training on codes, policies and procedures was not always sufficiently robust, although this was partly driven by the proliferation of codes in the industry and the lack of specific guidance highlighted above;

27.3.4 **Adherence to required standards:** Adherence to required standards was not adequately reflected in incentive and promotion policies or decisions.

27.4 Many firms have sought in recent years to address the issues above, 'leading from the top' to implement firm-specific codes and processes, but the approaches have typically been individually defined resulting in even further complexity.

Question 28 – General

Box 7 on pages 36–37 *[of the consultation document]* 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?

28.1 The MPP agrees with the areas of uncertainty highlighted in the consultation document, including:

- Lack of clarity regarding trading relationships between dealers and end-users, in particular whether the dealer is acting as principal or agent and the associated level of fiduciary care owed to the end-user;
- Distinction between legitimate trading activity and inappropriate 'front-running';
- Distinction between legitimate trading activity and market manipulation, particularly with regard to risk management of options;
- Standards for external communication of market activity;
- Standards for internal communication of market activity;
- Lack of granular market-wide standards for client suitability;
- Allocation of new issues;
- Use of non-public information, including use for positioning in the anticipation of client trading flows and information controls between public and private side.

28.2 The above uncertainties are not helped by a lack of market-wide rules or detailed business standards and guidelines.

Question 29 – General

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?

Question 30 – Will these uncertainties be dealt with by current reforms?

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

Question 32 – Can the industry help to establish better standards of market practice?

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

Question 33 – Can the industry help to establish better standards of market practice?

How would any code tackle the design issues discussed in Section 5.4.3 *[of the consultation document]*, 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?

Questions 29, 30, 32 and 33 have been addressed together given the interdependence of the responses and recommendations offered.

29.1 In the view of the MPP, documented business standards can play an important role in establishing and reinforcing acceptable market conduct across FICC markets. The MPP emphasises the importance of regulator engagement when creating business standards, and therefore urges the industry and regulators to adopt a collaborative approach to the recommendations outlined below.

29.2 First, it is important to note that there are various different terms used to reference documentation of business standards – code of conduct, market standards, business standards, guidelines, rules, principles, etc. There is no universally agreed definition of these terms (and how they differ) and they are often used interchangeably. However, there can be material differences along two dimensions:

29.2.1 Principles versus rules – Principles are higher-level, requiring judgemental interpretation and application, while rules are more granular and prescriptive and require limited judgement to implement. The MPP considers that principles are important in driving behaviour and creating individual accountability, and typically provide a reference when more detailed rules or guidance are not available. Rules typically need to address specific situations;

29.2.2 Owner – The implication of rules or principles differs depending on whether they are owned by a regulator or by an industry body, or are embedded in a firm's own values or code of ethics.

29.3 In the recommendations below, the MPP refers to 'codes and standards' and specifies the principles versus rules based nature and owner.

29.4 The MPP favours the following approach:

29.4.1 A principles-based set of industry-wide business codes and standards for FICC markets (FICC Codes and Standards) should be established, cascading existing high-level principles (e.g. FCA Principles for Business) to a next level of detail specific to FICC wholesale markets. For example, the FICC Codes and Standards may include principles such as *"A dealer should ensure that it is always clear to a client on which basis they are acting on a particular transaction (i.e. principal or agent)"*.

29.4.2 The FICC Codes and Standards should be simple and easy to communicate. They should apply to all FICC market participants, including sell-side, buy-side and issuers. Initial development could be led by institutions active in the UK, but the aspiration over time would be for the Codes and Standards to apply to FICC market participants globally. There have been examples in the past of industry codes evolving to become adopted internationally, for example the Hedge Fund Standards Board or ISDA;

29.4.3 Consistent framework for managing breaches across the industry and within firms: In order to embed all elements of Codes and Standards within organisations there need to be robust and consistent implementation frameworks in place. During its work, the MPP has come across some strong examples of where this has been done. Core components of an effective framework include: clear governance and ownership; active employee engagement; consistency and transparency in the operation of the code and in the application of sanctions; robust and continuing evaluation;

29.4.4 A robust framework needs to take into account that code breaches are likely to occur at varying degrees of severity, from minor (which would not be in breach of any regulation, for example but not accepted practice either) to the very serious. Consistency is required in categorizing breaches, reporting them and applying sanctions. Metrics need to be established to form a basis for consolidated reporting on a regular basis, with line of sight to the relevant board or its sub-committee. Over time, such reporting reveals patterns that could assist in risk evaluation and mitigation. Transparency also allows real life events to become case studies and lessons that can be shared across a firm as part of an on-going training regime;

29.4.5 Firms should reflect relevant FICC Codes and Standards in internal codes of conduct, policies and procedures or other internal documents such as codes of ethics. Additional guidance should be developed by individual firms as required and communication and training should be sufficient that individuals within that firm understand external and internal expectations and how to deal with 'grey areas'. Training should include workshops and live discussions of real case studies, in addition to standard web-based training modules. Above all, the guidance offered needs to be practical and relevant to real-life situations that arise as purely conceptual training can miss its mark.

29.4.6 Historically, this type of approach has worked in practice with the initial production of the Code of Conduct[33] and Market Abuse Code, which covered regulated instruments traded on exchange, or referred to such traded products. The then FSA consulted extensively on its introduction and included in that Code practical examples derived from consultation, which helped in its interpretation and application. Additionally, the regulator allowed for telephone enquiries and meetings on specific fact patterns and produced a regular briefing paper, 'Market Watch', which raised areas of potential concern and provided guidance to the market. The regulator intervened in some instances where there was genuine disagreement in the market around certain practices and prosecuted individuals who breached the codes.

29.4.7 Prior to the FSA codes was the old 'Grey Paper' regulation of the wholesale markets by the Bank of England. This took the form of a high level description of expected standards in the wholesale markets, covering regulated and unregulated products (i.e. including wholesale deposits and FX as well as derivatives and bonds with wholesale counterparts). While its perimeter with the rest of the regulatory world was complex, the idea of a different type of oversight by the Bank of England was sound and the standards widely adopted and well enforced at that time. The MPP is not proposing to 'turn the clock back' but rather to resurrect past practices that served to enhance fairness and effectiveness in wholesale financial markets and embed these in a framework fit for 21st century demands.

29.4.8 Such examples demonstrate how well-designed and sufficiently enforced standards and case studies have been effective from time to time in the past. While these examples had a greater degree of regulatory ownership than the approach recommended by the MPP, our suggested regulatory endorsement should have a similar effect while attempting to create guidance that has broader applicability across different market participants and ultimately geographies, to the extent that the framework is taken up beyond the UK.

29.5 Individuals should positively attest to their understanding of the relevant internal and external standards on at least an annual basis. Behaviour of individuals should be regularly assessed and actions taken to

[33] The Code of Market Conduct (MAR 1): http://fshandbook.info/FS/html/handbook/MAR

address inappropriate behaviour. Compensation and other incentives should also be aligned with the adoption of appropriate business standards. In addition, adherence to the FICC Codes and Standards and the firm's own Codes and Values, should be included in Contracts of Employment where an acknowledgement that failure to comply might lead to dismissal, even if there were no regulatory breach.

29.6 Design issues related to the above approach are discussed further below:

29.6.1 Who should develop the proposed FICC Codes and Standards and related Guidelines / Case Studies? As noted above, the MPP is proposing an approach where these are developed by market participants as an immediate follow-on from the Review. A body will be required to:

- Develop, maintain and update the FICC Codes and Standards, Guidelines and Case Studies on an ongoing basis, with strong engagement with both market participants and, progressively, with regulators;
- Support communication of the FICC Codes and Standards, Guidelines and Case Studies into the wholesale markets;
- Align existing codes and standards;
- Provide a forum for discussion around any emerging or remaining uncertainties or interpretation, and;
- Provide a forum for the sharing and dissemination of best practice.

29.6.2 Such a body should have the following characteristics:

- Organisational independence from any individual firm;
- Exclusive focus on wholesale FICC Codes and Standards, and associated Guidelines and Case Studies. The body should not have a lobbying role on behalf of market participants;
- Access to specialist and cross-sectoral FICC market expertise, calling on industry experts and practitioners as required;
- Ongoing industry funding, for a small core team to develop, maintain and support communication of the standards;
- Credibility with regulators. To an extent, credibility will be a function of the level of independence and expertise, but it is worth highlighting, given the importance of regulatory engagement and support. The independence from regulators, including possible confidentiality on specific issues raised, will be important to initially encourage open engagement from market practitioners. However, it is recognised that a clear protocol needs to be established such that issues of significance if surpassed, cannot and should not be swept away;

- International focus and credibility with global firms operating in FICC markets;
- In an ideal world, the body would have credibility and a recognised role with supervisors of FICC markets around the world, though this could be developed progressively;
- A broad mandate across all FICC market participants, including sell-side, buy-side and market infrastructure, as well as established contact with corporates; and
- Effective and legitimate representation of a broad range of market participants, including end-users and those with public interest. This could include rotating positions and selection processes to ensure industry support, engagement and representation.

29.6.3 The potential for the Banking Standards Review Council (BSRC)[34] to play this role is discussed in our response to Question 38 – the specific question asked by the consultation;

29.6.4 It should be noted that an industry-led solution may run into problems of conflicts of interest between the various participants from time to time. In many cases, these could be resolved through goodwill of the parties involved, and often it is clear what the right thing to do is. But in some cases, clarifying 'grey areas' may go to the heart of economic issues between the buy-side, sell-side and issuers, and it is unclear how these could be resolved within an industry body that does not have the legal authority to arbitrate these matters. An independent person may be suitable, but has the downside of being more remote from the issues involved and less technically able to own / promulgate case studies;

29.6.5 How could regulatory endorsement be achieved? The MPP is in favour of seeking increasing regulatory endorsement over time. It could well be inevitable that any standards, guidelines or case studies would in any case be used by regulators in enforcement proceedings (where breached) as discussed in our response to Question 44. However, it has been noted how difficult it has been to get regulators to approve common standards in other areas (e.g. central banks failing to agree one version of NIPS[35] code; different implementation of G20 commitments on OTC derivatives). Different legal and regulatory requirements in each jurisdiction might also increase the risk that granular guidance or case studies would conflict with local practices, although current legal and regulatory requirements are typically not specific in the 'grey areas'. This emphasises further, the need for there to be an enduring body to engage with regulators and to explore, directly with them and via IOSCO, where international steps might be feasible;

29.6.6 The MPP hopes that the initiative would gain traction internationally, though it is recognised that such a process will be complicated by the large number of different regulators across and within geographies, and

[34] Banking Standards Review Council (BSRC): http://www.bankingstandardsreview.org.uk/

[35] The Non-Investment Products Code – For Principles and Broking Firms in the Wholesale Markets, November 2011 (NIPS): http://www.bankofengland.co.uk/markets/Documents/forex/fxjsc/nipscode1111.pdf

so engagement will likely need to be focused on regulators responsible for the largest areas of wholesale FICC activity. The MPP asks whether the FSB could potentially play a role in facilitating engagement with a broader set of regulators and drive international agreement across the main jurisdictions?;

29.6.7 As to the legal effect of the regulatory endorsement, there are a number of possibilities. One possibility, building upon the current approach adopted by the FCA in the context of market abuse would be for an endorsed code to be provided with the status of an evidential provision – in the same way as the briefly described examples of behaviour that are to be taken into account for the purposes of determining whether or not market abuse has been committed (such as in MAR 1.6.9 E). Thus compliance with the endorsed code would be evidence of compliance with the relevant rule, though not determinative ('tending to establish compliance' – or non-compliance - as explained in Chapter 6, Status of Provisions, on page 23 of the FCA Readers Guide);

29.6.8 How to ensure that market standards can be made sustainable given industry innovation over time? The proposed hybrid design of principle-based FICC Codes and Standards and detailed Guidelines and Case Studies should ensure both continuity and sustainability, provided that the responsible body is established robustly, with appropriate governance, resources and an enduring role in mind. The principle-based nature of the FICC Codes and Standards should ensure that they are not overly dependent on micro-structure and mechanics and thus that they are largely enduring through time. The Guidelines and Case Studies could be created on an ongoing basis, responding to changes in market structure or behaviour and the emergence of new 'grey areas' for consideration. There should be an open channel of communication between individual firms and the central body, so that any areas of uncertainty can be raised, potentially leading to the development of new (or changes to existing) Guidelines or Case Studies;

29.6.9 How to differentiate from existing codes? In the first instance, existing codes could serve as building blocks. However, even technical codes such as NIPS have not served to avoid problems in markets. It is likely that at a principles level there will be overlap between the various codes as they tend to be high level with the addition the FICC Codes and Standards providing a harmonising foundation. Existing Codes of Conduct should be used as input as the new Codes and Standards, and potentially for Guidelines and Case Studies if they extend to this level of detail. Additional codes or industry guidelines focused on technical aspects could continue to exist in parallel, but would ideally reference the FICC Codes and Standards, Guidelines and Case Studies for conduct-related issues to avoid duplication. In the long-term, the proposed FICC Codes and Standards, Guidelines and Case Studies would ideally replace existing industry codes as the primary source of reference;

29.6.10 How to give it teeth? The MPP's preferred approach to achieving adoption of the FICC Codes and Standards by firms and individuals is to incentivise adoption through regulatory endorsement. The reciprocal of this would be that regulators could use failure to act in line with the Codes and Standards as an indication that firms or individuals were acting inappropriately, unless alternative actions or behaviour can be shown to be appropriate and consistent with regulatory rules and principles. It is worth noting that the Banking Standards Review final report proposed a structure based on self-assessment followed by external verification, and annual reporting of the performance of participating banks. This approach would require the demonstration of progress on a range of qualitative and quantitative measures related to behaviours, capability and customer / client outcomes. It would be complemented by senior engagement, most likely with non-executive directors and regular published commentary by the BSRC, using transparency and disclosure as additional tools to effect change. Other possibilities include incorporation into employee contracts and incorporation into business contracts. A self-certification mechanism linked to the Senior Managers Regime (SMR) / Approved Persons[36] (APER) Regime could also be possible. The MPP recognises the challenges associated with enforcing such standards to unregulated firms (which is discussed in our response to Question 39);

29.6.11 Whether, and how, to customise FICC Codes and Standards for individual asset classes? Where possible, FICC Codes and Standards should be common across FICC asset classes, to reduce complexity and increase consistency. However, some of them are likely to need to be tailored to individual asset classes to reflect specific market structures. The MPP recommends that the aim should be for principles to be consistent; codes consistent by default unless market specifics dictate otherwise; but that guidelines and case studies are specific to asset classes and be granular and practical enough to show application of the standards in real life situations.

29.7 Some parallels between this and the City Code on Takeovers and Mergers can be drawn. The Takeover and Mergers Code[37] contains both a set of general principles, largely unchanged since their inception in the 1960s, and a body of 'case law' built up through advice and rulings the Panel on Takeovers and Mergers (who administer the Code) has issued over time. The Code has been given 'teeth' through statutory backing, which allows it to censure firms or ban them altogether from conducting transactions. The threat of exercising these powers is usually sufficient to discourage malpractice. As a result, they are only rarely

[36] FCA Approved Persons Regime: http://www.fca.org.uk/firms/being-regulated/approved/approved-persons
Statements of Principle and Code of Practice for Approved Persons (APER): http://fshandbook.info/FS/html/handbook/APER
[37] The Takeover Code, The Panel on Takeovers and Mergers: http://www.thetakeoverpanel.org.uk/the-code/

used in practice. The Panel itself is comprised of representatives from industry and professional associations and is self-funded through levies on transactions it oversees.

29.8 In addition to the above longer term recommendations, the MPP recommends the compilation of an index of existing codes and business standards across geographies, asset classes and participants. This would help market participants to navigate and understand existing sources of information on codes and business standards. This index could be created by the same central industry body recommended above.

29.9 The MPP also recommends that owners of existing codes or business standards work together with the proposed industry body and / or owners of other related codes and standards to increase the level of consistency and eliminate any significant or counter-productive conflicts. Again this would be a significant venture and not all bodies might be willing to cooperate. However, there is value in engagement and considerable benefits to be derived from improving consistency.

29.10 The above recommendations include a combination of roles for the industry, firms, regulators and individuals, although the MPP considers that the most critical element is for firms to ensure that the FICC Codes and Standards are appropriately understood and adopted by individuals within the firm (see previous point 29.5). Recommendations according to stakeholder group are summarised below.

Industry-level recommendations

29.11 Compilation of index of existing individual codes or business standards.

29.12 Establishment of an industry body to:

- Create new principles-based wholesale FICC Codes and Standards, with specific Guidance and Case Studies to illustrate practical interpretation of the Codes and Standards;
- Drive towards harmonisation where required;
- Engage with regulators to establish a modus operandi for working together to raise industry standards.

Firm-level

29.13 Upgrade internal codes of conduct, policies and procedures to ensure sufficient compliance and consistency with external FICC Codes and Standards, where relevant.

29.14 Embed compliance with codes into Contracts of Employment and include adherence to them as a compensation relevant measure.

29.15 Enhance training on conduct and business standards, including a combination of workshop-based and web-based training on a regular basis.

29.16 Develop a monitoring and sanctions framework that will hold individuals to account for complying with FICC Codes and Standards and ensure alignment of incentives – see our response to Questions 36 and 37 for further detail.

29.17 Establish surveillance processes to identify inappropriate behaviour and penalise individuals – see our response to Questions 41 and 42 for further detail.

Individuals

29.18 Take responsibility for understanding and acting in line with FICC Codes and Standards and in accordance with Guidelines relevant to the individual's responsibilities.

29.19 Flag any activities or behaviours which are not in line with FICC Codes and Standards or in 'grey areas', either to management within the firm or the FICC Codes and Standards body.

29.20 Positively attest on an annual basis that the individual understands the relevant FICC Codes and Standards and has reported any potential breaches.

Regulators

29.21 Consider endorsement of industry FICC Codes and Standards, Guidelines and Case Studies, provided there is consistency with regulatory principles, rules and good practice.

29.22 Engage pro-actively with other legislators and supervisors to drive towards international consistency of standards.

Question 31 – Will these uncertainties be dealt with by current reforms?

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?

31.1 There are mixed views in the MPP on whether a standard professional qualification would be materially beneficial in terms of improving behaviour in FICC markets.

31.2 Some argue that, in addition to the actions described above, a professional qualification would help to set appropriate standards of competence combined with a continuing level of professional training and assessment to ensure wide understanding of expected industry standards. Some members of the MPP recommend that individuals working in capital markets businesses should take a specific examination on market practices and conduct that is obligatory as for other professions such as accountants and lawyers. Some market participants also suggest establishing a country by country central industry information repository detailing previous conduct or professional training / qualifications that could be used by firms to reference check individuals prior to hiring.

31.3 Others argue, that while such an approach can be effective in ensuring a minimum level of competence, the qualification per se will not be sufficient to ensure the right behaviours, which has been the main driver of recent malpractice (rather than competence). All participants believe that it is the responsibility of firms to ensure that employees understand and behave in line with expected standards. This responsibility will be reinforced by the proposed Certification Regime (for those firms subject to its provisions) in the UK, which states that a firm must take reasonable care to ensure that no employee performs any certified functions without having been certified as fit and proper to do so, and that this certification is renewed on an annual basis.

Question 34 – Should the scope of regulation be extended?

In the context of implementing MiFID II, which of the FCA Principles for Businesses should apply in relation to MiFID business with Eligible Counterparties?

34.1 The FCA Principles for Business should apply to all activities, including interactions and transactions with MiFID eligible counterparties. However, there should remain differences in more detailed requirements of how the principles are applied to interactions with different types of client or counterparty. For example, suitability obligations are not necessary when dealing with eligible counterparties.

Question 35 – Should the scope of regulation be extended?

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 *[of the consultation document]*?

35.1 Spot FX and spot physical commodities are notable products out of scope of significant parts of regulation today (e.g. MiFID II and Dodd Frank). In light of recent examples of misconduct in the FX and commodities markets many argue that these products should be brought more fully within the scope of regulation. Most of the MPP agree that these products should be brought within the scope of regulation related to market conduct and behaviour, but not for example extend MiFID II / MiFIR or derivatives legislation to include these products.

35.2 However, in terms of designing such an extension, it would be highly complex and potentially not feasible to apply every aspect of regulation designed for other products and markets (e.g. trade reporting, capital requirements, etc), due to the different nature of FICC markets, participants and risks involved (there are many corporate users of these products). Any extension of the regulatory perimeter would need to be specifically designed, carefully considered and potential unintended consequences assessed, (e.g. impact in the real economy through additional expense for corporate users or reduced competition).

35.3 In the case of physical commodities, some market participants are already regulated by other regulators specific to their product, e.g. OFGEM[38] in the UK regulates energy markets and there is a joint regime between OFGEM and FCA for regulation of the markets aspect of this business (REMIT)[39].

35.4 One option that requires further investigation is whether manipulation of the price of these products should be made an offence under the market abuse regime (MAD, MAR).

[38] OFGEM: https://www.ofgem.gov.uk/
[39] REMIT: https://www.ofgem.gov.uk/gas/wholesale-market/european-market/remit

Section 5 – Responsibilities, Governance & Incentives

Question 36 – General

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?

Question 37 – Firm-wide initiatives to improve incentives and governance

Do respondents' agree that the thematic areas highlighted in Section 5.5 *[of the consultation document]?*

Do respondents' agree that the following themes 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?

Questions 36 and 37 have been addressed together, given the interdependence of the responses and recommendations offered.

Role in recent FICC market abuse cases

36.1 Recent cases of market abuse include those identified in the consultation document, i.e. benchmark manipulation (e.g. FX, LIBOR); price manipulation (e.g. traders placing orders to create artificial market positions); misuse of information (e.g. front-running and misleading clients); collusion and artificial restriction of physical supply to drive up prices.

36.2 The view of the MPP is that inadequacies in governance, accountability and incentive arrangements all played a role in the cases of market abuse. While much has been done to address these inadequacies, both through regulation and industry-led action, there is broad acknowledgement by the MPP that there is further to go to ensure that current 'best practices' become 'normal industry practice' and thus raise confidence in the fairness and effectiveness of FICC markets.

Proposed further steps by firms

36.3 The MPP acknowledges the commitment of many firms to improve their culture and governance, as well as the significant volume of regulatory initiatives that are currently underway (as listed in Appendix A). More time is needed before a judgement can be made on how effective both firm-led and ongoing regulatory initiatives will be in practice. However the MPP nevertheless recognises that further work will be needed given recognised challenges arising from both 'grey areas' and inconsistencies, combined with the desire to see more visible and explicit commitments to raising standards of market practice.

36.4 Given differences in the size, nature and structure of regulated firms on both the buy-side and sell-side, many additional solutions will need to be bespoke to individual firms. However, the industry, as well as regulators, can play a role in promoting best practice. We also anticipate continuing oversight by regulators across markets to ensure all participants are taking the requisite action to address issues of conduct and culture.

36.5 The areas where the MPP considers more action is likely to be necessary are:

36.5.1 **Board oversight of conduct risks:** The MPP believes that boards and senior management have understood the need for a strong culture and standards of behaviour. Much has been done in driving cultural change within individual banks and the tone of board / senior management discussions have shifted significantly. However there is still a question of whether they are able, in practice, to identify gaps between their stated values and what is happening for example on trading floors. The challenge therefore is to determine how oversight of this can occur in practice. Solutions will depend on the nature, scale and complexity of each firm's business and are covered in more detail in our response to Questions 40 to 49 – Surveillance & Penalties;

36.5.2 **Increased role for middle management:** More work is needed to cascade required conduct standards down through organisations, and the middle management layer is instrumental to this. Firms need to ensure that desk-level managers understand expected good conduct and are supported and encouraged to embed them, in addition to the examples of best practice given in our response to Question 29. The MPP suggests several ways to reinforce this, including: balanced scorecards for performance assessment (of the middle managers, and their assessment of the individuals that report to them); links between scorecard results and incentives; greater use of front office supervision to cover conduct issues (see also our responses to Questions 40 to 49 on Surveillance and Penalties); use of top-down, face-to-face training starting with senior management and cascading through the organisation with managers running discursive sessions to review how existing rules, codes and standards should apply in given situations. Such training should be rooted in any industry Code, Standards and Guidance / Case Studies introduced for wholesale FICC markets as a result of the Fair & Effective Markets Review;

36.5.3 **Further embedding conduct considerations in end-to-end HR practices:** While good conduct must be the foundation of a firm's culture, HR practices can reinforce this. To do so requires embedding conduct information and assessment in all HR processes, including recruitment, employee induction and on-boarding, performance evaluation, compensation, promotions and training. For example, firms should pay attention to a candidate's character and conduct as well as financial performance during the recruitment and on-boarding process. Further, to ensure consistency of conduct across the market, more firms could embed in their practices the requirement that employees comply with internal and industry codes of practice (as described in our response to Questions 27 to 35 relating to Standards of Market Practice). It has been suggested that this could be achieved through a firm's employees attesting to its Code of Ethics annually. Where appropriate, failure to then abide by a firm's Code of Ethics can therefore serve more meaningfully as grounds for dismissal;

36.5.4 **Improved compliance surveillance for FICC markets:** Closer monitoring and surveillance of FICC markets is important. This should include trade surveillance, where increased availability of data as a result of MiFID II / MiFIR and the G20 agenda for OTC derivatives will help to improve the effectiveness of monitoring. As it needs to address behaviours and conduct, surveillance should also include random monitoring of communications by staff (email, voice, chats), with use of keyword technology and predictive coding (as mentioned in Question 41 of our response) where possible to prioritise.

36.6 The MPP places particular emphasis on front office supervision given that supervisors are closer to actual transactions and clients; more able to observe misconduct by colleagues; and have better intuition and product understanding to recognise misconduct when it occurs. Given differences across firms, the MPP suggests solutions to the issues set out above should be led by individual firms, but sees a role for the FICC Codes and Standards body and regulators in promoting best practice (see below).

36.7 The MPP notes that even within a better controlled environment, there will remain vulnerability to market abuse by individual 'bad apples' due to the necessary role of individual judgment. As regulatory confidence in the control environment and soundness of culture in FICC firms improves, the MPP hopes that there will increasingly be the potential for differentiation in the way in which breaches are addressed whereby cases of deliberate wrongdoing, such as those that caused recent FX and LIBOR scandals, will be dealt with strictly (by criminal proceedings where possible), while negligent or accidental breaches might be dealt with by requests for procedural change, warnings or requirements for training, as listed above and discussed in our response to Question 44. This would incentivise further adoption of best practices and their consistent implementation.

Regulatory role

36.8 The MPP envisages the following are areas where regulators can help:

36.8.1 **Promotion of best practice:** To facilitate and encourage firms to develop better ways of raising standards, the MPP would encourage the FCA to use its thematic reviews to monitor progress, check for complete coverage across the market (large, small, buy-side, sell-side), and compile best practice for dissemination to the market, potentially working with the FICC Codes and Standards body for the latter. With appropriate industry involvement, the MPP believes this can be an effective tool to deliver improvements in standards. The MPP welcomes an appropriate mechanism to ensure the regulatory-industry dialogue happens, and that industry insights are not lost. One idea is for the FCA business plan to include follow-up thematic reviews on each of the themes identified above;

36.8.2 **Proposed certification regime:** There is concern across the MPP that removal of the Approved Persons Regime (APER) may result in firms, when hiring more junior staff, having less information. Current regulatory approval of new appointments results in systematic capture of information about individuals, which will be lost for persons more junior than senior managers under the Senior Managers and Certification Regimes;

36.8.3 **Cross-jurisdictional approach:** The MPP supports greater cross-jurisdictional adoption of consistent codes and standards, and consistent monitoring of conduct against these standards for FICC market participants in equivalent roles beyond banks.

Question 38 – Market-wide initiatives to align market conduct, incentives and governance

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?

38.1 In our response to Question 29, the MPP outlines the characteristics required for the body responsible for developing FICC Codes and Standards, Guidelines and Case Studies. The extent to which the BSRC could play a role to help raise FICC market standards is thus dependent on the extent to which it meets or could meet these characteristics.

38.2 The BSRC meets a number of the required characteristics, including organisational independence, exclusive focus on standards (i.e. it does not play a lobbying role), industry funding (albeit within the UK currently) and regulatory credibility.

38.3 However, there are some key characteristics that the BSRC does not currently meet, particularly the global mandate (the BSRC is UK-focused, albeit the UK is a major centre for FICC markets) and a mandate across all market participants (the BSRC was established to define banking standards). The extent to which it would be feasible for the BSRC to evolve and address these aspects should be explored.

38.4 At the same time, it needs to be acknowledged that other codes and standards have been developed which are relevant for wholesale FICC markets, both within individual firms and also by other bodies - for example the ACI Model Code[40] or the CFA Institute's Code of Ethics[41].

38.5 Within the MPP there is a strong desire to build on existing codes and standards and to avoid setting up a new body if this can possibly be avoided. Therefore the MPP proposes, after the closing of the consultation, to engage with the BSRC and other bodies expressing interest, and who have credible contributions to make, to explore options for a way forward and then to define the necessary steps for cohesive industry action on a cross-sectoral and international basis for wholesale FICC markets.

[40] ACI Financial Markets Association Model Code: http://www.acifma.com/ethical-conduct-financial-markets

[41] CFA Institute Code of Ethics and Standards of Professional Conduct: http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2014.n6.1

Question 39 – Regulatory initiatives to align market conduct, incentives and governance

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?

39.1 As outlined in our response to Question 36, paragraph 36.8, the MPP considers that regulators have largely put in place (or proposed) sufficient frameworks to strengthen personal accountability, incentives and governance. At this early stage it is still unclear how new legislation (e.g. the Senior Managers and Certification Regime) will work in practice and therefore its potential broader applicability. The emphasis of the MPP response is on the importance for all firms in wholesale FICC markets to adopt more robust internal processes based on best practice, rather than for authorities to introduce more regulation at this stage.

39.2 In the shorter term the MPP does not consider that the Senior Managers and Certification Regimes proposed by the PRA and FCA should be extended to non-bank firms, given the continuing work to determine more precisely how these rules will be finalised. A minority of the MPP have suggested that in the longer term, consideration should be given to appropriate adaptation followed by potential extension. However, other members of the MPP have concerns over the risks associated with adopting a one-size-fits-all approach.

39.3 It is important to recognise that bank regimes already apply to some non-bank firms (specifically those PRA regulated UK investment firms with permission to deal in investments as principal). There are also proposals from the PRA / FCA to amend the existing Approved Persons Regime for insurers[42] to introduce separate but parallel Senior Manager and Conduct Regimes, driven by the need to implement the Solvency II Directive[43].

39.4 In practice, by giving immediate attention to the development of Codes, Standards and Guidelines specifically for FICC markets, the industry will be defining appropriate best practice that could serve as a useful contribution for any future regulation that may be envisaged.

[42] FCA Consultation Paper, CP14/25: Changes to the Approved Persons Regime for Solvency II firms, 26/11/2014: http://www.fca.org.uk/your-fca/documents/consultation-papers/cp14-25

[43] Solvency II Directive (2009/138/EC): http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:335:0001:0155:en:PDF

Section 6 – Surveillance & Penalties

Question 40 – General

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?

40.1 Clarifying standards applicable to the FICC markets in the manner described in our response to Questions 27 to 35 would also assist in the determining of the types of surveillance required, and the MPP comments further in response to the subsequent questions as to what further steps firms and the industry can take in this regard.

40.2 In the view of the MPP the clear priority for wholesale FICC markets is for enhanced collaboration between industry and the regulators in the creation of clearer expected best practices and guidelines and for firms and the regulator to adopt a more pre-emptive approach in identifying and preventing potential failures. Enhanced monitoring and surveillance have an important part to play. In the future, with more pro-active and pre-emptive engagement, we could envisage an environment where formal enforcement could be reserved for the most serious matters and would accordingly have more impact and effect than it is today as cases will stand out more to the market.

40.3 As an example of a model that appears to be working effectively elsewhere, we draw attention to the Treasury Market Practices Group (TMPG)[44] that has been running for several years in the United States. The TMPG is a private sector organisation sponsored by the Federal Reserve Bank of New York. Its objectives and full charter can be found using the website link from the footnote below.

[44] http://www.newyorkfed.org/tmpg/

Question 41 – Firm-level surveillance

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?

Taking each of the elements of the question in turn:

Firm-level surveillance

41.1 Over and above potential data-led surveillance solutions, in the view of the MPP further work is required to strengthen front office ownership of surveillance issues and thus improve the three lines of defence model and the ownership of risks and issues by the front office.

41.2 Unsurprisingly, firms have focussed on areas within the regulatory perimeter and those of perceived higher risk to the market and / or regulatory intervention – such as the equities markets. Accordingly the sophistication and extent of surveillance for wholesale FICC markets activities within firms differs depending on the market in which they are operating.

41.3 Recent events have made clear the need to enhance surveillance and oversight of areas historically treated as lower risk. The MPP therefore agrees that further work is required in this area, although notes that this is already underway in relation to the FX markets in light of the FCA's requirement on many firms to review in detail their controls around certain behaviours and attest to the adequacy of their controls (which will include surveillance).

41.4 Enhancing surveillance mechanisms must go hand in hand with the classification of what are acceptable and best standards of behaviour for specific markets.

Whistleblowing

41.5 The MPP accepts that there is more the industry could do in discussing and agreeing best practice in relation to the promotion of effective whistleblowing policies within firms. The proposed requirement within the Senior Managers Regime (SMR) that the Chairpersons of PRA-regulated firms take responsibility for the oversight of the integrity and independence of their firm's policies and procedures on whistleblowing has highlighted the priority of this area. They are also responsible for ensuring that staff who raise concerns are protected from detrimental treatment, which will likely assist in ensuring this issue is appropriately prioritised by those firms subject to the new regime.

41.6 Firms can themselves ensure that whistleblowing is embedded within their culture by articulating clearly the standards expected throughout their organisations, and by which behaviours can be measured.

41.7 The MPP does not consider a simple read across of the SMR to sectors of FICC markets currently outside its scope, but does consider that standards for whistleblowing should be consistent for all market participants. This is a good example of where best practice could be shared from which clear industry guidelines would be established and implemented.

41.8 The US model of incentivising whistleblowing, while potentially effective, is not something the majority of the MPP would support, running counter to developing a culture of accountability, echoing a joint PRA / FCA findings[45] note to the Treasury Select Committee published in July 2014. It was felt that in addition to whistleblowing, an internal reward approach could be aligned to championing behaviours and standards to echo this model of incentivisation but in a more positive manner. However, this should be left to individual firms to explore how best to implement so that it would be consistent with their culture.

Firm-level surveillance through 'big data' / other potentially effective tools

41.9 There is a number of different facets to technological surveillance – not least the use of Enterprise Resource Planning (ERP) systems to monitor controls. Experience tends to show, however, that key word surveillance has proven ineffective as a method of surveillance due to the wide variation in words used. A lexicon-based approach can identify potential issues but can also create more false flags, and so become inefficient in terms of time and cost. Those reviewing these flags also require a detailed understanding of the activity taking place to be able to determine appropriate cause for concern.

41.10 'Big-data' usage is a possible longer-term solution, but its adoption would be expensive and time consuming and its usefulness is as yet unproven. It may therefore be appropriate to consider the wider use of 'predictive coding' as a half-way house to 'big data'. This goes beyond simply looking for key words and instead looks to identify irregularities in patterns of behaviour such as; communications through

[45] http://www.fca.org.uk/news/financial-incentives-for-whistleblowers

unofficial channels (personal e-mail, messenger / chat forums); leaving the office at peculiar times or unusual working hours; missing mandatory block leave; consideration of previous roles and responsibilities within the organisation.

41.11 The MPP agrees that a cross-industry working group with input from potential FinTech vendors and the regulatory authorities could provide a useful forum to explore areas of common concern and solutions.

Question 42 – Firm-level penalties

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)?

The MPP has the following suggestions:

Firms could do more

42.1 Employment law considerations mean firms are naturally very careful in their application of penalties to employees and concerned to follow appropriate practices so as to ensure employees are treated fairly. The burden of proof on employers when investigating disciplinary action or raising concerns to regulators is substantial and exposes employers to significant challenges and risks.

42.2 The new proposed requirements relating to certified persons under the Senior Managers Regime (SMR) will to some extent address this issue by requiring firms to take primary responsibility for determining and certifying the fitness and propriety of their most relevant staff, and notifying the regulator of breaches. However the SMR does not change fundamental employee rights.

42.3 Firms subject to the Senior Managers Regime will have to develop enhanced policies relating to the identification of breaches, and the determination and certification of the fitness and propriety of their staff, which will to some extent address the desire that firms do more to ensure their staff behave appropriately, and are disciplined (or cease to be certified) if they do not.

42.4 In addition, firms' approaches to the granting and paying of bonuses to staff can in effect achieve a similar outcome by expressly and clearly relating bonuses granted and paid to acceptable and unacceptable behaviours (via way of balanced scorecards for example), in addition to strong (or weak) financial performance.

References and registers

42.5 Enhanced references, together with the new certification requirement, should address some concerns relating to 'rolling bad apples' passing from one firm to another. However, as noted elsewhere, there is concern amongst the MPP that the current proposal that the FCA ceases to maintain a central register in respect of approved persons seems to be unhelpful in addressing that problem. We strongly encourage the FCA to review how to make the register a more effective tool, particularly for employees who are not certified.

42.6 There is recognition that recently firms have wanted to be seen to be taking hold of their approach to 'bad apples' more proactively rather than holding on to such individuals. However, there is evidence that 'bad apples' can move into the shadows of the industry (i.e. unregulated areas or weakly-regulated jurisdictions), and that firms should be mindful of individuals moving into same / similar capacity roles within the industry beyond the scope of effective regulation.

42.7 One way to address this challenge would be to improve the current limitations of references for new employment in conjunction with the reinstatement of a central register of accreditation which the regulators have moved away from. The industry is keen to engage with the regulator in this regard, as discussed in our response to questions relating to Standards of Market Practice.

Question 43 – Firm-level penalties

Could firms active in FICC markets do more to punish malpractice by other firms, for example by shifting business and reporting such behaviour to the authorities?

43.1 The MPP considers that, while there are occasions on which firms might take action to shift business to punish malpractice by other firms, it would likely only occur where there was a direct link between such malpractice and the firm in question. As noted in our response to Question 17, debate exists as to whether the use of market discipline is prevalent or effective, including concerns that increased concentration in certain FICC markets can curb the ability of clients to move business. Clients often are obliged primarily to look for best execution, such that other issues would typically play a secondary role in the determination of with whom to do business. Liquidity constraints in particular FICC markets will also sometimes act as a barrier to such action.

43.2 The MPP does not therefore consider that it is realistic to view this type of industry 'punishment' as the primary means of ensuring firms comply with applicable requirements. The promulgation of clearer standards as described previously is likely to be more effective.

43.3 Regulated firms are already obliged to report suspicious transactions that they observe and consideration should be given to the scope of that obligation. The MPP suggests that there could be more thematic feedback from regulators to market participants with regard to such reporting. This feedback would raise awareness of the types of behaviour with which the regulator is concerned, encourage a more open dialogue, and could assist with highlighting areas of concern that could be used as 'early warning' (as opposed to early intervention) as discussed in our response to Question 47 later in this section.

Question 44 – Regulatory-level surveillance and supervision

Is the current supervisory approach and level of intensity dedicated to supervising conduct within the UK wholesale FICC markets appropriate?

44.1 The MPP believes that the very different levels and intensity of regulator-led supervision in different markets did contribute to the relative de-prioritisation within some firms of their own surveillance and training in those parts of their business outside the regulatory perimeter. That said, there is widespread recognition that attention needs to be given to all areas of potential abuse or poor practice, regulated or not, and firms have taken steps to address their levels of surveillance as discussed in our response to Question 41.

44.2 As outlined in our response to Question 39 paragraph 39.2, the MPP does not consider a straightforward extension of the Senior Manager and Certification Regimes should be envisaged in the short term.

44.3 Critical to the successful regulatory supervision of wholesale markets is appropriate focus within the regulator and the employment and retention of suitably qualified and expert individuals. It will be important for the FCA and the Bank of England to have at their disposal adequate and expert resources. To this end, market participants stand ready to provide appropriate expert individuals on a secondment basis or through the use of expert / practitioner groups to maintain a strong dialogue with the regulators and provide targeted transfer of practical knowledge and guidance with interpretation.

44.4 Were the regulatory perimeter related to business standards to be expanded at a future point, further consideration should be given as to the optimum structure within the regulators for the oversight and supervision of all market conduct and structure issues for FICC markets on a seamless basis.

44.5 In particular, when the recommendations of the Fair & Effective Markets Review come to be addressed from the middle of 2015 onwards, it will be important for the industry to be able to engage with a co-ordinated and authoritative source of guidance on the application of the recommendations and how they are to be interpreted.

Question 45 – Regulatory-level surveillance and supervision

Are there ways to improve the data on FICC market trading behaviour available to the FCA, whether through the extension of the regulatory perimeter or otherwise?

45.1 The MPP understands that one of the main challenges for regulators (just as for market participants) is the ability to capture, analyse and utilise large data sets for surveillance purposes. The fact that regulators globally are taking different approaches to data collection is creating considerable challenges for regulated firms operating internationally, and it is by no means clear that the resulting data that is being collected is capable of consistently useful analysis by the regulators calling for it. Accordingly, before determining that additional data is required, the MPP suggests that as a first step the FCA could undertake an analysis of the extent to which there are gaps in the data it already receives and is expecting to receive under the EMIR and MiFIR regulations, against that which it believes it needs to monitor the markets it regulates adequately.

45.2 In addition, we would encourage the FCA to continue to engage with IOSCO in order that some framework consistency might emerge for markets that are global in nature.

45.3 With regard to the quality of the data already made available to the FCA, there have been a large number of FCA enforcement actions in respect of failures by firms in relation to the submission of transaction reporting information. Given the technical nature of the requirements, and the FCA's approach to treating the requirements as a strict liability, further enforcement actions (potentially attracting large fines based on the FCA's fining tariff) must be likely. While it is clearly important for the industry (and the regulator) that transaction reporting be undertaken properly, the MPP queries whether this is one of the areas that might benefit from other types of regulatory treatment (of the 'early intervention' type described in our response to Question 47), which might be more effective in addressing the underlying issues and lead to a general raising of data standards across FICC markets.

Question 46 – Regulatory-level penalties

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

46.1 The MPP accepts that the risk of enforcement is a necessary feature of the codes or standards of market practice. However, the overuse of enforcement action, and the escalation of fines, ultimately becomes self-defeating as affected firms, and their customers, simply treat those risks and costs as being part of the cost of being in business.

46.2 Disciplining individuals will likely have a more material impact on behaviour, though again needs to be reserved for serious cases. In addition, consideration could be given to whether some bearing of the cost of penalties might be imposed on employees' bonus pools, though such an approach would need to be proportionate, targeted and balanced with firms' current disciplinary practices. An approach that potentially exposes senior management remuneration to the consequences of bad behaviour undertaken in a different part of an institution could be helpful in promoting collective governance and cross-business line challenge.

46.3 The MPP therefore concludes that greater impact from enforcement action would be achieved by reserving formal enforcement action to the most serious cases, and targeting individuals in those most serious cases, while seeking to use other tools (including early intervention as discussed in our response to Question 47) in other cases.

46.4 This is particularly important if the industry and the regulator are to be successful in operating the guideline setting proposals outlined in our responses to Questions 27 to 35 earlier. That approach will require firms to feel free to raise issues of genuine uncertainty, where there might be some exposure to criticism for past behaviour, but in a context where the outcome would be the determination of what the appropriate standard of practice should be, and for all firms to be judged against the clarified standards. A pure enforcement-led approach to conduct regulation in the FICC markets would not be conducive to achieving this outcome.

46.5 The MPP would welcome any efforts to align the global interpretation of enforcement regimes which would help reduce the inter-jurisdictional impact (and in some cases intra-jurisdictional impact).

Question 47 – Regulatory-level penalties

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?

47.1 The MPP believes there is scope for additional use of different types of 'early intervention' powers by regulators, but such an approach could result in extremely rough justice if used in inappropriate cases so requires care in its application.

47.2 Certain examples from the past – such as the intervention requiring all firms who were behind with confirmation documentation in certain derivative markets from undertaking any further business and / or taking on any further clients until the backlog was remediated – were considered effective and fair by the MPP. Similarly, insisting that a firm strengthen a control function can be an appropriate type of 'early intervention' that could operate to raise standards without resorting to formal enforcement in certain circumstances.

47.3 Removing a firm's permission to conduct a certain type of business altogether for a period is more draconian, given that that may force that firm out of the business altogether, or that there could be harmful end-user / client consequences, and should therefore be reserved for the most extreme cases.

47.4 These suggestions are without prejudice to firm management's own responsibility to intervene where necessary. Ideally any regulatory intervention would normally take the form of encouragement to firm management itself to take steps to pre-empt an issue prior to it becoming so serious as to require any form of formal regulatory intervention.

Question 48 – Regulatory-level penalties

Is there a need to widen and or strengthen criminal sanctions for misconduct in FICC markets?

48.1 For the most serious cases of misconduct, the MPP accepts that criminal sanctions are required but the MPP is not aware of a need to strengthen the current applicable criminal law offences and sanctions. The MPP agrees in principle with the approach of seeking to have criminal law offences broadly aligned with the administrative law requirements of MAR (Market Abuse Regulation), but reserved for those cases involving dishonesty, and prosecuted only in the most serious cases.

Question 49 – Regulatory-level penalties

Is the approach set out in the Criminal Sanctions Market Abuse Directive appropriate for the United Kingdom?
Are there additional instruments or activities to those envisaged by the Directive that should be covered by the domestic criminal regime?

49.1 The UK Government has already decided against adopting CSMAD, opting instead to implement its own criminal regime for market abuse.

49.2 The MPP assumes that those updates may include supplementing the UK regime with a number of areas of CSMAD which are not currently covered in the UK in order to produce greater consistency within the UK between civil and criminal regimes and greater consistency with the EEA criminal regime. The MPP is supportive of this, however, the MPP thinks that careful consideration needs to be given on how to achieve this rather than the wholesale incorporation of the offences set out at Articles 3, 4, 5 and 6 of CSMAD. For example, the offences under CSMAD refer on a regular basis to the concept of intent but the UK offences under Criminal Justice Act 1993[46] (CJA) and the Financial Services Act 2012[47] use various related but different concepts such as knowledge and recklessness (and / or intent). The interrelation between these concepts needs to be thought through to ensure that the regime is amended as intended.

49.3 In addition, public policy debates may be required before widening the regime to encompass the scope of CSMAD offences - in particular in relation to wider corporate liability under CSMAD (for example, in the UK, the criminal offence of insider dealing only applies to individuals under s52 of the CJA, while market manipulation (now under the Financial Services Act 2012) has historically had a higher threshold common law test for corporate liability than is the case under CSMAD).

[46] Criminal Justice Act (1993): http://www.legislation.gov.uk/ukpga/1993/36/part/V
[47] Financial Services Act (2012): http://www.legislation.gov.uk/ukpga/2012/21/contents/enacted

Appendix A – Recent and in-train regulatory changes

A.1 Many regulatory reforms to the FICC and wider financial markets are currently either in the process of implementation, or are in the early stages of enforcement. Those relevant to the Fair and Effective Markets Review have been highlighted below.

European regulation:

- Alternative Investment Fund Managers Directive (AIFMD)
- Bank Recovery and Resolution Directive (BRRD)
- CRR / CRD IV
- EMIR
- MAD II / MAR
- MiFID II / MiFIR
- The Prospectus Directive
- EU extensions of the regulation and supervision of benchmarks

UK regulation:

- The Banking Reform Act
- The Certification Regime
- Establishment of the Banking Standards Review Council (BSRC)
- The Remuneration Code
- The Senior Managers Regime
- UK extensions of the regulation and supervision of benchmarks

US regulation (where referenced in the response):

- The Dodd-Frank Act
- The Volker Rule

A.2 Further consultations, proposals or reviews have also been delivered or are expected. Those relevant to the Fair and Effective Markets Review have been highlighted below:

- FCA's wholesale sector competition review
- FCA's best execution and payment for order flow thematic review
- FSB's Global Shadow Banking Report

Appendix B – Glossary of terms

Term	Explanation
Agency execution	Firms act on behalf of clients to execute the client orders in the market place. The client bears the market (price) risk; the agent firm has a fiduciary duty to search for and execute the client's order in the market in line with best execution requirements.
Basis risk	Basis risk is the price risk associated with imperfect hedging. It typically arises from differences between the risk being hedged and the instrument serving as the hedge. For example a difference in expiry date of two assets could lead to a divergence in prices.
Barrier option	A type of option which is either activated or cancelled if a pre-determined level of the underlying market price is reached.
Big data (approach to surveillance)	Sophisticated electronic platforms are used to search and correlate multiple sources and type of unstructured data – 'big data' – in order to detect instances of inappropriate behaviour. This data can include trading behaviour, communications, market patterns or any other data source deemed potentially relevant.
Binary events	A binary event is an event that can take only two possible outcomes. Barrier options can be an effective way to hedge against binary events, for example if a currency de-pegs from another currency.
Digital option	A type of option which pays out a fixed amount (or nothing) based on whether the underlying price reaches a particular level at a specific point in time.
Flashing prices	The practice of choosing to 'flash' your trading order to a limited number of market participants when the trading venue has a sub optimal price or is unable to fill the order in its entirety, as opposed to inter-market order routing whereby the trade would be executed on another venue. Therefore this could result in trade information not being made available to all potential investors.
Internalisation	The process by which transactions are matched within a dealer or other investment firm, either against its own book or against orders from other clients, rather than in the open market.

Term	Explanation
Last look	Last look practices in FX give market makers the ability to accept or reject orders immediately prior to acceptance. The practice allows market makers to withdraw from trades with counterparties who fail credit checks or from trades where the price has moved since the initial quote / offer was made (for example due to latency within systems used to communicate prices and place orders).
Latency	A measure of the speed at which a trade processes, i.e. the time between an order being requested by a participant and either executed or withdrawn.
Lexicon-based (approach to surveillance)	This is the practice of searching through the records of trading conversations using a lexicon of key words to detect instances of inappropriate behaviour.
Market discipline	The concept that in a competitive market clients can impose discipline on service providers in cases of poor conduct, by withdrawing business and placing business with a competitor. This provides an incentive for the service provider to behave appropriately, independent of any regulatory or legal requirements.
Market scalping	A trading strategy involving buying / selling securities around the bid / ask in order to make a series of small gains across a large number of short-term trading positions.
Predictive coding (approach to surveillance)	Linked to lexicon-based and 'big-data' approaches to surveillance, predictive coding is seen as a half-way house between the simplistic 'lexicon' approach and 'big data' approach. The 'predictive' nature of the coding aims to establish patterns of irregular behaviour that may indicate inappropriate behaviour such as; communications through unofficial channels (personal e-mail, messenger / chat forums); leaving the office at peculiar times or unusual working hours; missing mandatory block leave; consideration of previous roles and responsibilities within the organisation.
Principal execution	Firms operate as market-makers on a model of liquidity provision to their clients, hence undertake risk-taking and balance-sheet commitment. Clients select their counterparty based on the prices quoted pre-trade. The selected firm then bears the market (price) risk since it is committed to executing the trade at that price, therefore can incur profit / losses on the positions it holds.

Term	Explanation
Cross-subsidisation	The practice of under-pricing one product or service and covering potential losses using profits generated from a second, either between products, services, client groups or time frames. Note that cross-subsidised products and services may or may not be bundled together when offered to participants.
Regulatory arbitrage	A practice whereby firms capitalize on loopholes or inconsistencies in regulatory systems in order to circumvent unfavourable regulation. Arbitrage opportunities may be accomplished by a variety of tactics, including restructuring transactions, financial engineering and geographic relocation.
Speed Bump	A mechanism which can be used by trading venues to pause trades for a short period of time before they transact, delaying overall transaction times and reducing the possibility of any one participant exploiting potential arbitrage opportunities in the market due to their ability to trade at higher speeds.
Surveillance (techniques)	The practice of the monitoring of information and activities in order to measure, influence or control behaviour of market participants and / or operational processes. Surveillance can occur on multiple levels and therefore with varying consequences for market participants. Regulatory surveillance for example, can result in fines and / or sanctions to a firm or individual when the intention is to deter and penalise against perceived misconduct. Firm or industry level surveillance may be more focussed on monitoring and managing risk positions and operational processes. Surveillance techniques could include formal monitoring of internal communications and transaction reporting (automated or otherwise), as well as supervisory observations.
Tenor	The initial term length of a loan or credit instrument.
Third country	The term used by the European Commission to define any country of the world that is NOT one of the 28 EU (European Union) member States and EEA-EFTA (European Economic Area - European Free Trade Association) states (Iceland, Liechtenstein, Norway).

Appendix C – Acronyms

Acronym	Explanation
ACI	Association Cambiste Internationale (Financial Markets Association)
APER	Approved Persons Regime
BIS	Bank for International Settlements
BSRC	Banking Standards Review Council
CCP	Central Counterparty Clearing House
CDS	Credit Default Swap
CFA	Chartered Financial Analyst
CJA	Criminal Justice Act 2003
CLOB	Central Limit Order Book
CRD IV / CRR	Capital Requirements Directive / Regulation
CSMAD	Criminal Sanctions Market Abuse Directive
DMO	UK Debt Management Office
EEA	European Economic Area
EMIR	European Market Infrastructure Regulation
ERP	Enterprise Resource Planning
ESMA	European Securities and Markets Authority
FCA	Financial Conduct Authority
FED	Federal Reserve
FEMR	Fair and Effective Markets Review
FICC	Fixed Income, Currencies and Commodities (markets)
FinTech	Financial Technology Sector
FSB	Financial Stability Board
G10	Group of 10 Nations
G20	Group of 20 Nations
HY	High Yield
IBOR+	Major Inter-Bank Offer Rates (LIBOR, EURIBOR, TIBOR collectively)
ICMA	International Capital Markets Association
IG	Investment Grade
IOSCO	International Organisation of Securities Commissions
LIBOR	London Inter-Bank Offer Rate
M&A	Merger and Acquisition
MAD / MAR	Market Abuse Directive / Regulation
MDP	Multi Dealer Platform
MiFID / MiFID II / MiFIR	Market in Financial Instruments Directive (I and II) / Regulation
MNPI	Material Non-Public Information
MPP	Market Practitioner Panel
NIPS Code	Non-Investment Products Code
OFGEM	The Office of Gas and Electricity Markets
OIS	Overnight Indexed Swap (rate)
OTC	Over-The-Counter
OTF	Organised Trading Facility
PCBS	Parliamentary Commission on Banking Standards

Acronym	Explanation
PRA	Prudential Regulatory Authority
REMIT	EU Regulation on Energy Market Integrity & Transmission (No 1227/2011)
RFQ	Request For Quote
SDP	Single Dealer Platform
SEF	Swap Execution Facility
SMR	Senior Managers Regime
TMPG	Treasury Market Practices Group
VWAP	Volume Weighted Average Pricing

Appendix D – Membership of the MPP

Steering Committee:

Samir Assaf, HSBC

Jeremy Bennett, Independent

Mark Caplan, Scotiabank

Michael Cole-Fontayn, BNY Mellon

Chair – Elizabeth Corley, Allianz Global Investors

Michael Davie, LCH.Clearnet

Isabelle Ealet, Goldman Sachs

Colin Fan, Deutsche Bank

Eric Felder, Barclays

Simon Henry, Royal Dutch Shell

Michael Hintze, CQS

Gay Huey Evans, Independent

Frédéric Janbon, BNP Paribas

Richard Lambert, Independent

Jonathan Moulds, Independent

Charles Nichols, Unilever

Simon Pilcher, M&G

Richie Prager, BlackRock

Legal Advice to the Panel:

Michael Kent, Linklaters

Expert Group Chairs:

Governance and Control Environment – Sally Dewar, J.P. Morgan

Commodities – Mark Caplan, Scotiabank

Currencies – James Kemp, GFMA

Fixed Income, Rates Products – Peter Nielsen, RBS, Andrew Morton, Citi

Fixed Income, Spread Products – Rob Rooney, Morgan Stanley