27 January 2015

H.M. Treasury

The Bank of England

The Financial Conduct Authority

Dear Sir or Madam

Response to Consultation document titled "How fair and effective are the fixed income, foreign exchange and commodities markets?"

On behalf of the members of the Association for Financial Markets in Europe (**AFME**) and the FX Division and Commodities Working Group of the Global Financial Markets Association (**GFMA**)[1], we welcome the opportunity provided by the Bank of England (**BoE**), Financial Conduct Authority (**FCA**) and H.M. Treasury (together, the **Authorities**) to comment on the October 2014 Consultation document (the **Consultation**) that aims at evaluating the fairness and effectiveness of the Fixed Income, Currency and Commodities (**FICC**) markets.

While we believe that the overall structure of the FICC markets is fundamentally sound, it is important to recognise that recent issues around trading practices, controls and governance have challenged overall market functionality, affected public trust and prompted change. We fully support this initiative to solicit the industry's views on assessing the degree of fairness and effectiveness in the FICC markets and to ascertain what, if any, additional steps should be taken to more effectively monitor the functioning of these markets and provide a fair and balanced medium for all market participants.

This letter response has been divided into three parts. Part One sets out an Executive Summary. Part Two makes some high-level observations and comments on the subject of this Consultation and Part Three contains responses to the specific questions presented in the Consultation. In Part Three, we have, for ease of review, broken down some of the questions into their individual sub-questions and responded to each separately.

Please note that, unless stated otherwise, the views expressed in this letter apply across all asset classes and sub-asset classes in the FICC markets. Asset classes within FICC have varying characteristics; as the Consultation notes in section 2.1, "But taken together, FICC assets are unusually heterogeneous".

[1] A description of AFME and GFMA can be found in Annex 1.

Part One: Executive Summary

We support this initiative to solicit the industry's views on assessing the degree of fairness and effectiveness in the FICC markets. The need for high standards, and a continuing and rigorous focus on fairness and effectiveness in the FICC markets, is fully accepted. We encourage the Authorities to collaborate, where appropriate, with the industry to build a market-led framework, including future infrastructure, that builds on existing good practices and applies to all market participants.

Whilst we believe that the overall structure of the FICC markets is fundamentally sound, we understand and agree with the need to ascertain what additional steps should be taken to monitor more effectively the functioning of these markets and provide a fair and balanced environment for all market participants.

These additional steps should include those set out below:

- **Establishing uniform code of conduct frameworks of high-level principles** that are global but allow for appropriate regional variances in operational practices. These codes should be supplemented by dynamic market practice guidance, developed by the industry and endorsed by the regulators, around products and associated practices where actual or potential conflicts of interest are most prevalent. There should be some type of enforcement mechanism and sanctions supporting these codes and the industry will need to be closely involved in all stages of their development;
- **Extending more granular market practice guidance (for example, through the "Strengthening accountability in banking" regime)** for market participants at the day-to-day level, supported by tailored case studies with industry input to assist in resolving "grey" areas;
- **Fostering culture change in the industry** by embedding the principles of ethical behaviour, integrity and accountability throughout organisations, not just at board level;
- **Outlining best practice standards for front office supervision and control**;
- **Establishing an appropriately representative practitioner panel** which could comment constructively on proposed reforms before they are adopted;
- **Supporting criminal sanctions for unacceptable behaviour**, and rebalancing the regulatory enforcement focus away from inadvertent or accidental breaches;
- **Proactive and continuing revision of standards** in a dynamic and evolving market - what is applicable today may not be so at a later date; and
- **Considering the re-introduction of examinations** on relevant regulation and codes to be passed by individuals before working in the industry, as well as annual appraisals to confirm that knowledge is up to date.

Standardisation also has a role to play, although it is important to distinguish **standardisation of disclosure and reporting** (which we support and have helped establish) from **standardisation of issuance practices, procedures and operations,** which based on feedback from corporate issuers will likely result in more problems than it would solve.

Clarity, consistency and coordination are key principles that need to underpin any national or global regulatory initiative, and should be supported by a strong regulatory culture of surveillance and enforcement. Furthermore, standards of cross-border regulatory cooperation

and consistency should be strengthened as inconsistencies in the regulatory approach of different jurisdictions can cause unfavourable outcomes such as potential market fragmentation and regulatory arbitrage**.**

The Authorities are better placed today than at any time in the past to ensure clarity and consistency of application. They have been (and will continue to be) **provided with detailed market and trading information**, through extensive transaction reporting.

Whatever the outcome of the Consultation, we urge the Authorities to consider carefully, the many diverse, complex and positive features of today's FICC markets and the specific measures already underway:

- **The market maker model** is vital for the real economy by providing liquidity, enabling market participants to trade smoothly in and out of positions without excessive price volatility, providing certainty of credit exposure and enabling investor flows to raise financing.
- **Potential conflicts of interest will often arise in complex economies and markets: the key is how these are identified and managed.** The current conflict of interest rules under MiFID I (to be extended by MiFID II/R) which apply to authorised entities address these concerns.
- **Transparency helps ensure effective markets,** but inappropriate and excessive transparency could create unintended consequences: costs to investors could increase, issuers could be disincentivised from issuing bonds, positions could be inferred and market makers would be unable to hedge and unwind their risks, discouraging client trades and reducing liquidity in the market.
- **FICC markets are global and comprise distinct asset classes and sub-asset classes** and it is important that the individual characteristics of the component FICC markets are considered within context so as to develop an appropriate framework that promotes both effectiveness and fairness. A "one-size-fits-all" approach will likely damage markets. The global nature of FICC markets requires international authorities to work closely together to ensure that regulations are implemented effectively and work on a cross-border basis. Any measures should also factor the important underlying purpose of FICC markets which is to facilitate liquidity generation in the system to support efficient capital allocation.
- **Foreign exchange forms the basis of the global payments system** and as such any steps to widen existing derivatives regulation to include FX spot need to be considered carefully. The application of derivatives regulation to the FX spot market would have unintended consequences of disrupting this widely established and well-functioning market, which is of key importance.
- **In the commodities markets,** entities undertaking similar or analogous activities should be regulated uniformly, in a consistent manner, regardless of the nature of the market participant. There has been a transfer of market share in trading from the major investment banks to trading companies and other corporates, many of whom are active in the commodity derivatives market and currently unregulated. We also note that information asymmetries and imbalances are a natural feature of the commodities markets, and understood by the various participants.

- **No additional benchmarks beyond those already proposed by the UK authorities should be brought into scope at this time:** the UK already has a comprehensive framework around certain critical benchmarks. However, the proposed EU Benchmark regulation raises concern around the global consistency and the appropriate proportionality of any benchmark regulatory regime. Any disruption in the availability of key benchmarks, as the result of fragmented regulation, risks creating instability. Coordination and consistency of existing efforts to improve the robustness of benchmarks are more important than undertaking new initiatives.
- **Sufficient time should be devoted** to evaluating the effectiveness of existing and contemplated regulation, at both European and global levels. Specific measures already underway include:
    - **disclosure of inside information,** required by the MAD[2]/ MAR[3] and REMIT[4] market abuse regimes.
    - **increased monitoring and supervisory powers** under both existing (MiFID, EMIR[5] and MAD/MAR) and future (MiFID II/R and REMIT) regimes, to ensure appropriate behaviour by market participants.

Part Two: General observations and comments

Many recent initiatives are in train aimed at changing the structural and operational environment surrounding the financial services sector, including the FICC markets

These include the new outlook of the FCA as against that of its predecessor entity, the Financial Services Authority (**FSA**); proposed revisions to MiFID II/R; and MAD/MAR. These initiatives have focussed on protection of investors, market transparency, competition and market abuse and seek to improve market conduct by changing market practices and the behaviour of market participants. Furthermore, the recent prudential reforms which include new capital and liquidity requirements, will also significantly change the future landscape of the financial markets.

Transparency requirements and monitoring standards are likely to be key drivers of change

Transparency requirements:

a) Pre and post-trade transparency (will enhance price transparency): these regimes should be appropriately calibrated to preserve liquidity. This is particularly relevant for market makers who are constantly engaged in channelling liquidity.

b) Disclosure of inside information: the MAD/MAR and REMIT market abuse regimes provide, or will provide, greater transparency by widening the scope of publicly available information.

[2] Market Abuse Directive
[3] Market Abuse Regulation
[4] Regulation on Wholesale Energy Markets Integrity and Transparency
[5] European Market Infrastructure Regulation

Monitoring standards:

Current (MiFID, EMIR, MAD) and upcoming (MiFID II/R, MAD/MAR and REMIT) regimes grant monitoring and supervisory powers to ensure appropriate behaviour of market participants. This involves providing regulators with information, which is not publicly available, which is an important tool to enable regulators to help shape and influence market behaviour.

Results of initiatives currently under implementation (for example, MiFID II/R) should be established first as financial markets absorb their impact

The FICC markets have recently witnessed a significant number of initiatives and interventions that aim to improve overall functioning of the market. As some have not yet been fully implemented (such as MiFID II/R, MAD/MAR and REMIT), it is important that the effect of the current initiatives is evaluated after the market has substantially absorbed the impact of these changes. This will prevent contradictory initiatives and enable an objective analysis of the gaps and shortcomings which need to be plugged through further intervention. Supported by existing data that the Authorities have for risk monitoring, potential risks that do not exist currently can be identified.

This approach is not intended to oppose needed regulation but, rather, to recognise the multitude of initiatives that are filtering through the system whose impact has not yet been fully established. Any steps to widen regulation need to be considered carefully to avoid unintended consequences, including potentially disrupting established and well-functioning market systems.

We propose to work with the Authorities to bring about constructive change while building on existing good practices.

- ***Foster culture change in the industry:*** The industry should consciously strive to drive a clear change in thinking and approach towards doing business and managing risk. This will entail a strong leadership drive from senior management to make an objective assessment of the quality of control policies and procedures in place. Integrity and accountability at middle management and below are expected to be the key principles driving such culture change.
- ***Codes of Conduct regime:*** We see benefit in developing unified, globally agreed Codes of Conduct frameworks, that allow for appropriate regional variances in operational practices, with high-level principles setting out both acceptable practices (including safe harbours) and unacceptable practices. However, we recognise that it will take time to develop such codes and that there will be challenges in ensuring that these codes are detailed enough to be meaningful to the industry. We also believe that there should be some type of enforcement mechanism and sanctions supporting these codes and the industry will need to be closely involved in all stages of their development. In order to foster a culture of openness and frank discussion, we recommend that the Codes of Conduct regime of course be informed by discussions and coordination with regulators.
- ***Front office supervision/ control:*** Good practice guidelines for front office/ desk head supervision and control will be framed. We support industry Codes of Conduct as well as dynamic, regulator-endorsed market practice guidance which address current grey areas of

acceptable and unacceptable behaviour. The industry should have a mechanism for feeding through areas where guidance would be helpful. We support a renewed focus on the vitally important requirement for front office staff to know and understand these guidelines and to escalate a question if the facts fall into a previously undetermined or "grey" area. Such guidance will help provide greater clarity of understanding of evolving rules and principles. An independent body or group with the appropriate degree of expertise and knowledge regarding the FICC markets could play an important role in conjunction with industry participants in establishing such market practice guidance.

- ***Criminal sanctions:*** Authorities should focus regulatory enforcement action on those cases involving real intent to manipulate markets. These should normally be the subject of criminal proceedings, rebalancing the regulatory enforcement focus away from inadvertent or accidental breaches.
- ***Proactive adaptation going forward:*** In a dynamic and constantly evolving market environment, the policies, procedures and standards put into place will require continuous adaptation. This reflects the challenge of conducting business where the market environment is not static. Organisations should be able not only to keep abreast of such change but also proactively embrace such change.

Standardisation has a role to play

Achieving optimal standardisation of market practices across market participants is desirable for the overall efficiency and effectiveness it can achieve. However, standardisation also needs to be balanced carefully against the ability to innovate and compete more effectively. Also, it is important to distinguish standardisation of disclosure and reporting (which we support and indeed have helped establish), from standardisation of issuance practices, procedures and operations, which based on feedback from corporate issuers will achieve only limited benefits and will likely result in more problems than it would solve.

Standardisation of corporate bond issuance in particular has a separate set of considerations. We are not aware that large corporate bond issuers are anything other than satisfied with the effectiveness and efficiency of the corporate bond issuance process, as a general matter. We note that standardisation will introduce the greatest challenges for small and mid-cap corporates looking to raise financing through the debt markets because smaller firms require the greatest flexibility when structuring debt. Therefore, mandating standardisation will create inconsistency with the Capital Markets Union objective of expanding access to financing through the bond markets for small and mid-cap firms.

From an issuer's perspective, the key attributes of a successful bond issuance process are investor diversification, attracting anchor investors, cementing long-term investor relationships and minimising cost of capital. Different issuers often require specific structures, credit support and covenant flexibility, depending on the industry or business model, and it is therefore important that issuers and investors maintain the flexibility to tailor and agree each transaction to meet those requirements. Issuers are also keen to maintain flexibility over timing of issuance in order to capture the right market opportunity. For large corporate issuers the traditional bank-run allocation process helps achieve these objectives. Alternative bond issuance processes, such as auction and retention, do not offer these wide-ranging benefits and therefore, have not been widely adopted by issuers. Separately, the issuance process for credit intensive

products can differ from that of more frequently issued, less credit intensive products (in terms of disclosure details) and hence, merit closer alignment.

Any moves towards standardisation, particularly around issuance practices, should therefore be undertaken on a voluntary basis.

Standardisation of disclosure and reporting can always be improved. It will be helpful to leverage, refresh and update, as appropriate, existing standardised disclosure frameworks (for example, BoE/ ECB reporting in securitisation[6], AFME High Yield reporting and the Loan Market Association's (**LMA**) European Private Placement documentation initiative).

Clarity, consistency and coordination are key principles that will help achieve the Consultation's objectives

In order to achieve the Consultation's objectives, we would urge the Authorities to ensure regulations are implemented effectively and consistently, and work on a cross-border basis. Given the global nature of FICC markets, conflicting or competing initiatives undermine overall objectives. Any initiatives should not only be clear in terms of their actual scope and boundaries but also apply consistently across jurisdictions and in line with applicable legislation. Initiatives that straddle asset classes in FICC markets need to be closely coordinated and adopt common approaches, supported by a strong regulatory culture of surveillance and enforcement. Furthermore, initiatives need to enable cross-border flows by taking into account the local and global orientation of individual asset classes in the FICC product spectrum. We believe adherence to these principles is one of the greatest challenges of the successful implementation of any initiative that aims to change market practices or behaviour of market participants.

Authorities are better placed to ensure clarity and consistency of application

In recent years, regulators have been provided with detailed market and trading information in order to facilitate the framing of appropriate framework. We believe that regulators (generally speaking) are today better placed to take a holistic view of the dynamics of the marketplace and the issues faced than at any time in the past. Therefore, regulators need to ensure that all elements of European legislation are implemented and applied consistently across jurisdictions. In this respect, we would urge the Authorities to consider playing a leadership role in current discussions regarding Capital Markets Union.

Whatever the outcome of the Consultation, we urge the Authorities to consider carefully, the many diverse, complex and positive features of today's FICC markets

FICC markets comprise distinct asset classes and sub-asset classes

The asset classes and sub-asset classes within FICC exhibit varying characteristics ranging from (i) breadth of market activity (global, regional, local), (ii) trading volumes, (iii) trading behaviour of market participants, and (iv) form of trading. For example, FX spot is a truly global

[6] AFME played a leading role in working with both the BoE and the ECB in formulating their loan-level data and other information disclosure requirements for use of the Discount Window Facility and Eurosystem repo facilities for asset-backed securities, in particular during 2010 and 2011. AFME continues to engage constructively with the ECB, European Commission and ESMA regarding ongoing discussions to increase disclosure and transparency in European securitisation, specifically Article 8b of Regulation 1060/2009.

market whereas the same can be said for only certain segments of the fixed income market. Similarly, FX and fixed income are predominantly dealer markets whereas commodities are not.

It is, therefore, important that these individual characteristics of the component FICC markets are noted, accepted and considered carefully in any process which seeks to develop new frameworks, standards or regulatory responses which seek further to promote effectiveness and fairness.

The market maker model is vital for the real economy

This model entails the market maker facilitating their clients' needs by offering a price on any asset based on the risks and the costs of the specific transaction. The principal advantages of this model include (i) provision of liquidity enabling market participants to trade smoothly in and out of positions without excessive price volatility; (ii) certainty for market counterparties of their credit exposure; (iii) enabling of investor flows; and (iv) provision of sufficient liquidity to enable raising of financing.

Part Three: Responses to questions in the Consultation

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

Q1

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

Broadly, we believe the Consultation successfully defines the parameters of "fair" and "effective".

"Fair" means:

- "Clear and consistently applied standards of market practice";
- "Transparency";
- "Open access";
- "Competition on the basis of merit"; and
- "Integrity".

"Effective" means:

- operating in ways "that allow end users, borrowers and end-investors to undertake transactions, including risk transfer and the channelling of savings to investment in a predictable way"; and
- "competitive prices".

Further, we note the following:

- an important component of market effectiveness is the continued availability of liquidity that helps achieve efficient allocation of capital in the system;
- as the Consultation notes in section 3.4, there are instances where there is a trade-off between the objectives. While such instances may not be completely eliminated, it is important to understand and, where possible, measure the extent to which such trade-offs exist in order to achieve the optimal balance; and
- the objective should be to build a fair and balanced environment for *all* market participants - not just one sector.

It is difficult to say how these definitions compare with those in other markets, jurisdictions, organisations or legislation, not least because these terms are not necessarily specifically defined or used elsewhere. We acknowledge that the Authorities are under discussions with other international regulators around the parameters of these definitions, especially given the global nature of FICC markets.

Evaluating the fairness and effectiveness of FICC markets

Q2a

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?

Publicly available information relating to the recent series of FICC market abuses is limited to decision notices published by regulators. Criminal proceedings may be pending, and there is undoubtedly much information that has not been made public. Therefore, this question is difficult to answer.

But based on the information that we have, it seems clear that behaviour has taken place which was absolutely unacceptable and we fully support measures designed to further improve conduct across the sector. We would comment that all of the themes are important factors.

There has over the last few years been an emphasis on "tone from the top". This of course is critically important, and CEOs and boards of banks have repeatedly stressed the need for ethical behaviour. However, it is equally important for such ethics and standards of behaviour to form an integral part of the culture of the entire organisation at all levels, from the very top to the most junior staff who do not interact directly with CEOs and boards. Careers and conduct of more junior or mid-level employees, as with many large and complex organisations, are more directly influenced by their line managers than by CEOs and boards. Implementing such a change in culture is a long term project: New City Agenda, in their recent report on culture in retail banking, stated that the process of changing culture will take a generation. The same is likely to be true in FICC; although much has been done, much remains to be done.

See further our answer to Question 36.

Evaluating the fairness and effectiveness of FICC markets

Q2b

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?

We believe that many of the factors that the Consultation identifies as problematic for fair and effective markets have been addressed by a wide range of recent initiatives. In many cases, these initiatives have either been introduced very recently (e.g. UK regulation of benchmarks) or have not yet come into effect (e.g. MiFID II/R, EU Benchmarks Regulation) and will fundamentally change the way in which the FICC markets operate. As such, at present, it is not possible to identify the risks that will create deficiencies in FICC markets going forward. It is important that any initiatives are relevant to the risk landscape. Also, we stress that in the future regulatory landscape, authorities will receive large amounts of data through transaction reporting from the industry; we believe this will permit authorities to monitor the entire FICC market landscape, identify risks and ensure effective enforcement.

One of the challenges for fair and effective global markets is divergent regional interpretations of high level principles, inconsistent reforms and conflicting rulemaking. Therefore, the introduction and implementation of initiatives should be coordinated internationally. Furthermore, any initiatives should embed sufficient flexibility to react to changing market circumstances and provide for workable cross-border arrangements which do not undermine cross-border activities and avoid subjecting participants to duplicative and/or conflicting rules.

Certain markets, such as asset-backed securities (**ABS**), have undergone significant change since the onset of the financial crisis resulting in declining issuance volumes. Several reasons accounted for this phenomenon including a rapid decline in investor appetite for ABS following poor credit and price performance in certain sectors such as US subprime mortgages and CDOs, followed by the introduction of new regulatory treatment of ABS which is today viewed by many senior policymakers as overly conservative (especially relative to other forms of secured funding) given the strong track record of performance of ABS in Europe. This has rendered the current European ABS market inefficient for issuers and other participants in the market. These issues surrounding ABS have prevented originating banks from accessing a reliable tool for not just funding, but also risk transfer and channelling of savings. All of these functions are important components of market effectiveness, as the Consultation notes.

We would also comment that, in terms of other important areas of vulnerability, there should be a focus on current deficiencies in the area of cross-border regulatory cooperation. There are numerous examples of inconsistencies in the regulatory approach of different jurisdictions which can cause market fragmentation and give rise to difficulty of application, especially in relation to global markets. Such inconsistencies increase the risk of regulatory arbitrage. Please see further our response to Question 11. We strongly support the aims of the FSB[7] in this area, as set out in the letter of 7 November 2014 to the G20 leaders, namely to have an approach "based on cooperation, peer review and outcomes-based approaches to resolving cross-border

[7] Financial Stability Board

issues" and the need to build a system combining common international standards including deference to other approaches where appropriate.

Lastly, we reiterate our comment in Question 1 that it is important to build a fair and balanced environment for *all* market participants - not just one sector.

Specific issues in FICC markets: Barrier and digital options

Q3

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

Actual or potential conflicts of interest and conduct "grey" areas associated with them may exist whenever a liquidity provider acting in a principal capacity accesses the market between the inception and conclusion of a transaction with a client. Barriers and digital options are just two examples of such products and practices. It is important to note that all these products / practices were brought to the market due to the benefits they provide to clients. Focus should therefore concentrate on the means of managing fairly the actual or potential conflicts of interest associated with the aforementioned products / practices, as to which we set out some ideas below.

The Consultation notes in Section 5, Box 5 that "Unlike simpler options, barrier and digital options have discontinuous pay-off profiles. This means that the value of the derivative increases or decreases when the price of the underlying asset reaches a certain level." As the price of the underlying asset approaches the option trigger level, the volatility in the price of the option is at its maximum and possibly also maximises the potential risk exposure. This aspect of the option behaviour may create the incentive for market participants to trade in the underlying asset in an attempt to move the market thereby, averting occurrence of the barrier event ('defending' a barrier option). It is observed that the discrete nature of the barrier and the generally large size of such positions can therefore result in price distortion events intraday.

At the same time, market participants also need to adhere to the best practice of not over-hedging their risk positions. This practice includes unwinding of hedges in the run up to a barrier being hit. Normal trading practices include hedges being unwound up to the point when a barrier is triggered. It is sometimes difficult to differentiate between what qualifies as prudent and justifiable risk management, on the one hand, and defending an option on the other.

In order to deal with the risks presented by trading in the barrier options, we believe that market participants will need to ensure they are taking positions that reflect the risk profile of the underlying trade. In particular, they will need to carefully manage the risk as the reference barrier is approached. The triggering of barriers could have significant financial implications as some of the hedges involved can have significant notional size. It therefore, becomes important to take actions commensurate to the size of the position being managed and which certainly avoids a situation where excessive risk is assumed.

In order to provide market participants with some guidance for managing risks, we see benefit in a global Code of Conduct, that allows for appropriate regional variances in operational practices, detailing high-level principles of acceptable behaviour and supplemented by dynamic market practice guidance, developed by the industry and endorsed by the regulators, around products and associated practices where actual or potential conflicts of interest are most prevalent. Where possible, these rules should be agreed as global standards.

Such rules would need to establish clarity around information barriers internally within firms regarding what is communicated with respect to barrier levels. We are of the view that the unintended consequence of any real-time circulation of information around barrier positions is that the market is able to gauge such positions early and may, therefore, be able to exploit such information to their benefit. We believe the adoption of such best practice standard is important to preserve overall fairness and effectiveness in the context of trading barrier and digital options.

Specific issues in FICC markets: Market microstructure

Q4

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

FICC asset classes cannot be considered as one single market when being assessed in the context of market microstructure. The FICC markets are highly heterogeneous and are comprised of distinct asset classes (e.g. fixed income, derivatives, currencies and commodities), sub-asset classes (e.g. FX spot, covered bonds, government bonds, corporate bonds) and products within those sub-asset classes. For example, a corporate may have several hundred outstanding tradable bonds, each with differing characteristics, such as coupon rate, covenant structures and currency denominations. The difference in the characteristics of these products is driven by the specifics of their market. For example, for investors, asset heterogeneity enhances market effectiveness by providing a greater number of choices to hedge, carry out better risk management or diversify their positions (i.e. wider availability of assets to choose from). It also promotes fairness as it enhances competition and provides clients with varying options as to market participation. Further, a key driver of asset heterogeneity for fixed income is the differing financing needs of entities such as corporates.

Further, these differing characteristics of FICC asset classes and the specifics of their markets determine the trading structures necessary for ensuring fair and effective markets. Examples of factors that impact market structure include use of the product, secondary market liquidity, client investment strategy, risk transfer, the size of the trade, client needs and pricing factors. We also note that fundamental changes to the trading structure of the FICC markets are in train as a result of regulation, one of the most significant being MiFID II/R.

Market making is another such structure that is critical to ensuring liquidity and effective pricing, which is determined by the nature of the FICC markets. Certain FICC asset classes (e.g.

fixed income) have low secondary market liquidity, which is one factor that drives the need for market making. Instruments with low secondary market liquidity generally trade less frequently but can have a high or low turnover volume in terms of currency value. The trading behaviours of instruments with low secondary market liquidity mean that at any given time, the number of buyers and sellers in the asset may be significantly different – whereby at any given time, an investor may not find an immediate buyer or seller or the required volume of asset. In such a market, facilitation of trading is essential. Applying an order book or agency broker model for such a market would result in investors either having to wait for a buyer or seller to emerge or accept a price that does not reflect the quality of the asset. In the market maker model, the market maker facilitates the investors' needs by acting as the buyer to every seller and the seller to every buyer by holding an inventory of assets. For investors and issuers, the role of the market maker is critical.

For example, bonds are generally low risk products from a credit standpoint because the investor is legally entitled to receive the set coupon during the term of the bond and principal upon maturity unless the issuing entity defaults. As the risk associated with a bond is based on the probability of default of the issuing entity, both the returns and losses on bond investments are typically low. Therefore, the general investment strategy for fixed income cash bonds is mainly instructional and long term with an expectation of lower returns (i.e. low yield). However, it should be noted that there is a large spectrum of risk profiles in the cash bond market. As a result, a large proportion of bonds never trade or trade highly infrequently as the investors are "buy to hold".

Transparency is important for ensuring effective markets. For example, price transparency enables investors and other market participants to achieve optimal price discovery. Further, for the Authorities, better availability of details of transactions permits risks around financial stability to be monitored, resulting in more effective measures and more timely interventions (where necessary). Currently, there is a great deal of transparency in the FICC markets. For example, investors continuously receive electronic trading data across a range of products in the form of quotes, indicative prices, executable prices and volumes for OTC and on-venue trading. In the corporate bond markets, it is common to trade on various platforms such as Bloomberg, which gives investors access to indicative prices from over a hundred market makers on a regular basis on a large number of bonds. The same can be said for the FX spot market, where it is estimated that up to 90% of trading is electronic, with pricing being available through multiple dealer platforms, single dealer platforms, retail providers as well as through channels such as Google or Yahoo Finance. The level of transparency will be even further enhanced in the FICC markets through the introduction of pre and post-trade transparency requirements under MiFID II/R as well as other fundamental changes outside of Europe, such as those in the US.

It is important to note, however, that inappropriate and excessive transparency could lead to severe unintended consequences. In particular, costs to investors (impacting pension funds and insurance companies) could increase and for instance, issuers would be disincentivised from issuing bonds, contrary to the objectives of the European Commission. These impacts would be a consequence of market makers being unable to hedge and unwind their risks due to others being able to infer their positions (the "winner's curse"), which are exacerbated the larger the trade risk and the less frequently the instrument trades on the secondary market, leading to

market makers being discouraged from facilitating client trades through the commitment of capital, reducing liquidity in the market.

In the bond markets, an investment firm purchasing new issues will need assurance that they can manage their portfolios by selling the bond when necessary. Without the provision of liquidity by market makers, investment firms would be less willing to purchase new issues or would require higher yields, increasing borrowing costs for corporates and discouraging new issuance.

In terms of market access, we are not aware of any significant barriers to entry or exit beyond the natural need for building networks of trading relationships in the FICC markets. However, mandatory clearing does introduce barrier risks to trading, especially for small firms. Specifically, the costs associated with registering with a CCP, which are increased as a result of concentration on certain CCPs, mean that smaller firms can only clear indirectly through existing clearing members. As such, the need to clear through a major dealer (an existing clearing member) and the actual cost associated with clearing, limits the ability of smaller firms to access certain markets.

The fixed income markets support multiple trading venues with differing levels of access to facilitate liquidity. For example, certain interdealer venues make certain requirements such as restricting membership to credit institutions and financial services providers, or minimum liable equity capital to become a clearing member to guarantee the suitability of the liquidity provider. In the European sovereign debt market, interdealer brokers are formally recognised as such and are only permitted to allow access to registered Primary Dealers. However, these arrangements are the counterpart to obligations undertaken by primary dealers including, for example, an obligation to quote a price to clients on request, an obligation to stream prices into interdealer venues, and primary market participation obligations. Primary dealers require these interdealer venues, where counterparties operate under similar or identical obligations, in order to effectively discharge their primary dealership obligations, service their end-user clients and provide primary market liquidity to sovereign issuers. It is therefore, reasonable to conclude that instances of limited market access actually serve to enhance liquidity provisions which, in turn, help drive fairness and effectiveness in the overall system.

Trading in the FX market occurs on a global scale and is supported by a very large daily turnover of transactions. The significant turnover is explained by the fact that FX is traded not only as an asset itself but also because of underlying global trade and capital flows and specifically that FX acts as the global payments system. Furthermore, FX is decentralised and hence, there is no single market place or dominant venue.

In addition, the recent prudential reforms which include new capital and liquidity requirements will also significantly change the future landscape of the financial markets. Furthermore, as initiatives have not yet been fully implemented (such as MiFID II/R), it is important that the effect of the current initiatives is evaluated after the market has substantially absorbed the impact of these changes. We understand and agree with the need to ascertain what, if any, additional steps should be taken to monitor more effectively the functioning of these markets and provide a fair and balanced medium for all market participants. Additionally, given the global nature of many parts of the FICC markets, it is important that any proposed changes to the market microstructure are consistently applied across jurisdictions. Operational consistency

across jurisdictions will enable firms to leverage off their existing publication systems, which will reduce the cost of implementation on an initial and ongoing basis, resulting in reduced end costs to investors of the MiFID II/R regime, or other equivalent regimes. For example, the U.S. has different pre and post-trade transparency requirements and trade reporting platforms e.g. TRACE for fixed income. It will therefore, be important that any initiatives look to achieve operational consistency across jurisdictions so that European market participants, investors and issuers are not at a disadvantage to their US counterparts due to an unlevel playing field.

Specific issues in FICC markets: in fixed income

Q5

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

As discussed above in Question 4, the market structure for a given product is driven by the nature of the product and the market specifics. The fixed income markets are highly heterogeneous, buy-to-hold (as a result, typically have low secondary market liquidity, especially corporate bonds) and primarily wholesale. Therefore, fixed income markets are heavily reliant on the fully functioning institutional model in order to meet growing long-term funding requirements.

As such, fixed income markets are mainly OTC bilateral markets where the dealer or market maker is a party to each trade. Investors query market makers for prices and pick one that provides the best product (e.g. package of product, settlement risk, price and operational support). Dealers and clients can deal directly or through an intermediary, such as through a voice broker or electronic trading venue.

Electronification of trading also introduces other significant challenges. For example, electronic trading favours more sophisticated market participants that can trade with a shorter latency, to the disadvantage of smaller firms, reducing competition and liquidity in the market. Also, in times of market stress, typically, there is greater volatility and less liquidity in electronic trading environments compared to voice trading: this introduces pro-cyclicality risks.

Traditional methods of order execution are increasingly becoming automated and execution methods have now expanded to offer market participants a variety of market models. Further, we believe that the introduction of MiFID II/R regime is likely to continue to increase the use of electronic trading venues for a wide range of market participants. It is recognised that the electronic platforms offer efficiencies through functionality such as straight-through processing and automated trade matching, as well as through improved cross-market connectivity. Electronic data facilities already provide pre-trade market data of bonds to all market participants, encompassing information such as quotes, indicative prices, executable prices, firm prices and volumes. However, electronic trading is most appropriate for the most liquid instruments, where there is sufficient trading flow. Further, it should be noted that even on electronic platforms, due to the nature of bonds, platforms automate the request for quote (**RFQ**) model between dealers and clients rather than providing a complete electronic all-to-all execution on exchange as in the automated equity-trading model.

Subject to suitable protections for retail investors, retail trading is operationally very suitable to electronic trading. There are some examples of retail bonds such as the German Mittelstandsmarkt market. Large household names such as Air Berlin as well as smaller companies have issued retail-sized tranches online rather than a conventional institutional-sized bond. However, the market is nascent and has its challenges. For example, steel and power supplier SIAG Schaaf Industrie AG filed for insolvency less than a year after issuing a bond on the Frankfurt Stock Exchange.

Admittedly, electronic platforms can provide greater transparency and support price discovery, which may be desirable for many market participants. However, in the case of less liquid products and large trades in any product, such as corporate bonds, this could generate the "winner's curse", and the publicising of such transactions could add additional market risk to the market makers and investors. According to a recent Bank of International Settlements (**BIS**) report, "*large trades by institutional investors with a potentially large impact on prices are less suitable for trading on platforms and typically require dealer intermediation or split transactions into smaller amounts to optimise trading performance on electronic platforms*"[8].

We observe already that while 40% of European investment grade corporate bond trades are executed on the three main electronic platforms (Bloomberg, MarketAxess, and Tradeweb), these tend to account for smaller trades (usually <€2 million), with the larger ticket sizes being executed between dealers and investors via phone. While there is clearly scope for platforms to support larger transaction sizes, we would expect the direct dealer-investor model to persist in the case of corporate bond markets.

While we fully support greater transparency and price discovery in the fixed income market, certain activities and requirements around hedging and unwinding of positions present a natural constraint in maximising transparency levels, whereby (as discussed in Question 4) inappropriate transparency could lead to a decline in liquidity, an increase in investor costs and disincentivises issuers from raising financing through the debt markets, contrary to the European Commission's growth objectives.

Specific issues in FICC markets: in fixed income

Q6

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?

Achieving optimal standardisation of market practices across market participants is desirable for the overall efficiency and effectiveness it can achieve. For example, standardisation across a broad range of fixed income products in multiple jurisdictions can result in a more integrated market that will be deeper, more liquid, and improve ease of access for issuers. However, standardisation also needs to be balanced carefully against the ability to innovate and compete

[8] BIS (2014) "Market-making and proprietary trading: industry trends, drivers and policy implications" CGFS Papers No. 52. http://www.bis.org/publ/cgfs52.pdf

more effectively. It is important to distinguish standardisation of disclosure and reporting (which we support and indeed have helped establish, and which is relatively non-controversial), from standardisation of issuance practices, procedures and operations, which is a more complex subject.

Standardisation of disclosure and reporting can always be improved. It will be helpful to leverage, refresh and update, as appropriate, existing standardised disclosure frameworks (for example, BoE/ ECB reporting in securitisation[9], AFME High Yield reporting and the LMA's European Private Placement documentation initiative).

Standardisation of issuance practices, procedures and operations is a concept on which many varying views are held across the market both on the sell- and buy-side, and indeed within the issuer and investor communities. The fixed income markets are highly heterogeneous with a broad range of products, which are driven by the needs of the issuer base. Standardisation of corporate bond issuance in particular has a separate set of considerations. We are not aware that large corporate bond issuers are anything other than satisfied with the effectiveness and efficiency of the corporate bond issuance process, as a general matter. We note that standardisation will introduce the greatest challenges for small and mid-cap corporates looking to raise financing through the debt markets because smaller firms require the greatest flexibility when structuring debt. Therefore, mandating standardisation will create inconsistency with the Capital Markets Union objective of expanding access to financing through the bond markets for small and mid-cap firms.

From an issuer's perspective, the key attributes of a successful bond issuance process are investor diversification, attracting anchor investors, cementing long-term investor relationships and minimising cost of capital. As a matter of corporate governance, treasury functions of issuers are obliged to secure the ability to fund at all times and at the best price. Furthermore, issuers are keen to maintain flexibility over timing of issuance in order to capture the right market opportunity. For large corporate issuers, the traditional bank-run allocation process helps achieve these objectives. Alternative bond issuance processes, such as auction and retention, do not offer these wide-ranging benefits and therefore, have not been widely adopted by issuers.

Separately, the issuance process for credit intensive products can differ from that of more frequently issued, less credit intensive products (in terms of disclosure details) and hence, merit closer alignment.

Any moves towards standardisation should not restrict the ability of corporates to raise financing through the debt markets (whereby issuance in Europe is already significantly smaller than the US markets) and, therefore, should only be undertaken on a voluntary basis.

[9] AFME played a leading role in working with both the BoE and the ECB in formulating their loan-level data and other information disclosure requirements for use of the Discount Window Facility and Eurosystem repo facilities for asset-backed securities, in particular during 2010 and 2011.

Specific issues in FICC markets: in fixed income

Q7

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

From an issuer's perspective, the key attributes of a successful bond issuance process are investor diversification, attracting anchor investors, cementing long-term investor relationships and minimising cost of capital. Typically, issuers are keen to maintain flexibility over timing of issuance in order to capture the right market opportunity. For large corporate issuers the traditional bank-run allocation process helps achieve these objectives. The allocation process entails regular dialogue between the issuer and its bank which enables the issuer to remain abreast of investor appetite and preferences at all times. This helps secondary market performance as it enables careful selection of the investors on issuance, so that there are sufficient sellers to provide the liquidity necessary for the transaction to complete its bedding down but not so many that the bond price or spread is adversely impacted.

The auction process does not enable an issuer to decide which investors will receive bonds on issuance (since this is dictated by price), and though it may confer on the borrower some pricing advantage on the transaction, corporate issuers generally choose not to issue by auction. It may, however, still be possible for corporate issuers to evaluate this avenue on a case by case basis. Auctions are effective for those borrowers, primarily sovereign, who already have an established presence in the market, are well-understood by investors and have multiple bond issues of different maturities already trading in the secondary market providing reference points for pricing.

Retention transactions are rare today. They involve the borrower setting the price and size of a new issue prior to it being offered to potential investors. Each manager in the syndicate receives a fixed amount of bonds which it then seeks to sell to investors. The advantage for the issuer is guaranteed funding at a specific level as each of the managers is obliged to purchase their portion of bonds, irrespective of whether they have investors prepared to buy them. Unsold bonds remain on the books of the individual manager. There is no flexibility in the pricing or size of the deal as a result of investor feedback or changing market conditions.

Issuers have the option of re-opening bonds that are outstanding and this approach can improve liquidity, subject to the required updating of prospectuses and possible changes to taxation regimes. Separately, issuers also seem comfortable with series issuance of bonds as this can deliver benefits such as helping to establish a yield curve for their credit.

It is relatively common for lead managers to make deal statistics available to investors. These itemise the transaction's distribution by geographic segments and by investor type. However, publication of individual allocations raises questions of data protection and confidentiality in relation to both investors and borrowers that would need to be addressed (notably under MiFID II/R client-facing rules).

Specific issues in FICC markets: in foreign exchange

Q8

Are there risks associated with internalisation and last look practices? Are there barriers preventing increased pre and post-trade transparency in foreign exchange markets?

With respect to barriers to entry and transparency, it is important to note that the FX market forms the basis of the global payments system. The volume of FX transactions is high with a daily notional turnover, as recently reported by the BIS of US$5.3 trillion per day. The market is geographically dispersed, de-centralised and primarily OTC. It is quote-driven (as opposed to order-driven which is the case with equities, for instance) where prices for any two currencies are relative and driven by market factors. Since there is no dominant market venue, prices are quoted on a number of different trading platforms.

Any steps to widen existing derivatives regulation to include FX spot need to be considered carefully. The application of derivatives regulation to the FX spot market would have unintended consequences of disrupting this widely established and well-functioning market which is of key importance.

We have focused on the implications of some developments and practices in the FX market (i.e. internalisation and last look practice) and also on transparency standards in the different segments of this market.

Internalisation

Internalisation refers to the process whereby a bank aims to leverage its own internal positions to find natural hedges, rather than accessing external liquidity. Low volatility in major currencies pairs has also prompted an environment in which banks have considered internalising trades. Internalisation offers the following key benefits:

- More competitive prices to market participants essentially mirroring the benefits of the 'portfolio effect' i.e. greater market share leading to better pricing,
- Narrowing the bid-offer spread compared to what the external market can offer provided that the markets are regularly stable, and
- Minimising payment of brokerage fees therefore minimising the costs of execution.

The Consultation proposes that internalisation poses a drawback in that liquidity is viewed to be concentrated in the hands of a few institutions, especially during times of crisis. However, it should be noted that liquidity concentration in times of crisis is not an internalisation-triggered phenomena as it is typically witnessed in all markets facing disruption.

Last look practice

Certainty of liquidity is a very important consideration for all market participants as it helps them manage their trading positions efficiently and without being exposed to the risks presented by market fluctuations. In the FX markets, this aspect comes into focus as last look practices have been developed that give market makers the chance to accept or reject a trade immediately prior to acceptance. This practice enables market makers to effectively manage latency and counterparty credit risk and as a result, offer tighter spreads.

We believe that, in order to preserve market fairness and effectiveness in such circumstances, transparency and clear guidance on the usage of last look would be effective tools that ensured that market participants were informed that last look is applied to trading on that particular platform. Such intimation of applicable standards and practices will enable market participants to tailor their respective strategies by assessing the trade-off between better pricing/ tighter spreads and potential execution uncertainty. The inclusion of such standards within global Codes of Conduct should allow for appropriate regional variances in operational practices. These codes should be supplemented by dynamic market practice guidance, developed by the industry and endorsed by the regulators, around products and associated practices where actual or potential conflicts of interest are most prevalent in order to promote consistency across the global FX market.

We note that the practice of last look is not unique to the FX markets; different considerations may apply in other parts of FICC.

Transparency in the FX market

The FX spot market is characteristically highly transparent with wide ranging sources of data and market information being available publicly or through commercial sources. It should, however, be noted that participants in the FX spot market have multiple choices to assess spot market prices, some of which include multi dealer platforms, retail platforms and Google. Additionally, surveys conducted by central banks also provide relevant market data.

In terms of the FX derivatives market, there have been initiatives undertaken globally aimed at increasing levels of transparency. This effort has entailed the inclusion of real-time 'tape' distribution for MiFID Financial Instruments in Europe, FX non-deliverable forwards (**NDFs**) and FX options in the US. Given that regulation is not yet fully embedded, it is difficult to ascertain, at this stage, its precise impact in terms of benefits and shortcomings.

Specific issues in FICC markets: in foreign exchange

Q9

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

Please refer direct to final FSB report on benchmarks[10]; and GFMA Global FX Division response to original consultation document[11].

[10] Available on http://www.financialstabilityboard.org/2014/09/r_140930/?page_moved=1
[11] Available on http://www.gfma.org/correspondence/item.aspx?id=613

Specific issues in FICC markets: in commodities

Q10

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

We do not believe there are any material barriers preventing greater transparency and, furthermore, are of the view that the incoming regime will provide sufficient transparency also in the OTC commodity derivative markets provided it applies to all entities carrying on similar or analogous activities, such as unregulated trading companies and corporates who are active in the commodity derivatives markets.

For the reasons cited below, we do not believe any new transparency requirements are necessary, although we do believe that the MiFID II/R requirements should apply to the unregulated entities referred to above.

As noted in the Consultation, "market participants who have physical businesses often have an information advantage over those who only participate in derivatives markets" (Section 5, paragraph 18 – see also Section 2, paragraph 11). In our view, it is necessary to distinguish between equality of opportunity to obtain information and equality of information held. Information asymmetries and imbalances are a natural feature of the commodities markets and understood by the various participants. Rather than undermining competition, information imbalances (provided the information is not abused) can lead to increased participation in the derivatives markets which in turn enables producers, processors and end users to manage their risks.

We consider it vitally important that stakeholders have easy access to all of the information that market players are required to make available to the market and believe that barriers should be removed. Furthermore, we would stress that if any new proposal is to be made, it should (a) avoid duplicative requirements and ensure alignment among regimes, including any existing regime(s); (b) appropriately consider the necessary implementation measures and cross-border impacts.

Transparency

Price transparency: As noted (para 17, p. 25) "for many major commodities, price formation is driven by exchange-traded derivatives markets, where pricing is fairly transparent. Prices in the underlying physical markets are linked to derivatives prices by robust arbitrage relationships."

We believe that the upcoming MiFID II/R requirements will increase pre and post-trade transparency. Although we expect the continuation of bespoke transactions being traded OTC and the use of voice brokers in some physical markets (particularly the gas and wholesale power markets), the introduction of the new 'organised trading facility' (**OTF**) is likely to attract "much FICC business that was traditionally classified as OTC which will now be subject to the transparency rules covering venues." (para 3 p. 23).

It is difficult to comment at this stage on "further measures that could be taken to enhance transparency in the OTC commodity derivatives markets", and also difficult to see what else could be disclosed short of confidential information that is not currently, and should not be, required to be disclosed to the market.

Disclosure of information: As highlighted above, it is important to note that information asymmetries and imbalances are a natural feature of the commodities markets and understood by the various participants. Rather than undermining competition, information imbalances (provided the information is not abused) can lead to increased participation in the derivatives markets which enables producers, processors and end users to manage their risks.

Additional reporting obligations: Furthermore, we would note that the EMIR reporting regime applies to commodity derivatives, including those traded OTC, and provides greater transparency relating to the risks related to such trading and new reporting regimes will come in to force in due course (under MiFID II/R and REMIT).

Moreover, we fully support the G20 initiatives aiming to enhance the transparency in physical commodity markets (production and storage) though we highlight that on some commodities (precious metals and rare earths, for instance) such transparency does not yet exist, primarily because of the reluctance of some countries in a dominant position to publish relevant data on a regular basis.

Market structure

As the Consultation acknowledges, the FICC markets are not homogeneous.

One key way in which the commodities markets differ from the other FICC markets is that they are not based on the dealer model described in the Box 2 of Section 2.

As identified in the Consultation, 'a recent trend across many commodity markets has been the transfer of market share in commodities trading from the major investment banks to vertically integrated commodity firms, combining both a physical business and a trading arm' (Section 2, paragraph 11). Many of those trading companies and other corporates who are active in the commodity derivatives market are currently unregulated.

In our view, it is important that entities undertaking similar or analogous activities should be regulated in a consistent manner and standards and market practices should apply uniformly to the relevant activities, regardless of the nature of the market participant.

Accordingly, we advocate a narrow definition of ancillary activities exemption under MiFID II/R and believe that unregulated trading companies and corporates who are active in the commodity derivatives markets should be brought within the scope of the MiFID II/R regime.

Specific issues in FICC markets: regulatory measures

Q11

Are there any areas of FICC markets where regulatory measures or internationally coordinated regulatory action are necessary to address fundamental structural problems that exist?

We refer to our response to Question 2 and would highlight the following examples where inconsistent approaches to the scope and application of regulatory initiatives have created issues of fragmentation, application and potential for regulatory arbitrage.

(a) EMIR equivalence requirements – delays in resolution creating problems in relation to clearing requirements, extraterritorial application of the secondary legislation and intragroup exemptions.

(b) MiFID II/MiFIR – reciprocity requirements which will create trading issues for EU entities.

(c) Bank Structure Reform – uncertainties created by equivalence and reciprocity requirements in the current draft of the proposed legislation.

(d) Financial Transactions Tax (**FTT**) - broad extraterritorial application of the proposed legislation.

(e) Dodd-Frank Act (CFTC[12]) – "first mover" issues on clearing mandate, the Swap Execution Facility (**SEF**) requirements, trade reporting.

Furthermore, we refer the Authorities to AFME's recent paper "An agenda for capital markets union" dated November 2014 (**AFME CMU Paper**)[13] and the consultation report of "IOSCO[14] Task Force on Cross-Border Regulation" dated November 2014 (**IOSCO Cross-Border Regulation Consultation Report**)[15].

Specific issues in FICC markets: conflicts of interest and information flows

Q12

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

Potential conflicts of interest will always arise in complex economies and markets and are impossible to eliminate completely. The key issue is how such potential conflicts of interest are identified and managed fairly and under a framework of robust systems and controls. Obviously, conflicts of interest that can potentially arise will differ across FICC products (for example, bonds versus FICC derivatives).

Potential conflicts of interest can arise through the sharing of information, both internally within a firm or even externally, in the course of what is perceived to be normal trading practices. This includes providing market colour to counterparties as part of the natural relationship between a bank and its client/wider market. The process of exchanging such information needs to ensure that any data or market information that is designated as confidential is recognised as such and appropriate mechanisms are in place that prevents its unintended abuse.

A useful example of the dangers of poorly calibrated regulation seeking to address potential conflicts of interest can be found in the extensive work undertaken in Europe to seek to address the perceived conflicts of interest in the "issuer-pays" model of credit ratings. In Europe, mandatory rotation of credit rating agencies was proposed, initially across all fixed income products. Mandatory rotation sought to remove the choice of issuers and investors to decide

[12] US Commodity Futures Trading Commission
[13] Available on http://www.afme.eu/WorkArea/DownloadAsset.aspx?id=12155
[14] International Organization of Securities Commissions
[15] Available on https://www.iosco.org/library/pubdocs/pdf/IOSCOPD466.pdf

who should, or should not, rate their transactions, and was subject to much criticism from users of credit ratings and others. A better solution, which was even adopted before the proposed regulation, was found in the voluntary change in behaviour by the credit rating agencies themselves - the agencies adopted and strengthened their own internal procedures which are also today subject to appropriate supervision. This is therefore a good example of an industry-led solution supported by supervision.

The current conflict of interest rules under MiFID I (and to be extended by MiFID II/R) which apply to authorised entities address these concerns. Furthermore, efforts can be made to establish greater clarity and global consistency in defining what is either appropriate or inappropriate to be communicated amongst market participants, both internally and externally. This will allow market participants to better manage risk, further smooth the important market making process and deliver satisfactory service to their customers.

Neither is it the case that asymmetry of information is per se wrong. One party may quite legitimately pay a service provider (for example, a credit rating agency) for information which is technically confidential but nevertheless perfectly legitimate to use. That is why a market for such service providers, and the information and intellectual property they create and supply, exists.

We reiterate the point made in response to Question 10 that the same rules should apply to those unregulated trading companies and corporates who are active in the commodity derivatives markets. As discussed above, we believe a narrow interpretation of the ancillary activities exemption under MiFID II/R is therefore necessary.

There will be greater information flow under the new regulatory landscape, which will, inevitably, introduce new data confidentiality issues. Therefore, potential risks relating to abuse of confidential information can only be assessed following the implementation of the major regulatory changes.

Lastly, the Consultation notes in Figure A on page 30 that "Structural break-up of FICC firms to separate market making and other complementary FICC businesses" is an option in the spectrum of responses to 'information flow' issues. AFME supports initiatives to segregate communications relating to agency and principal flows, but notes that electronic communication lends itself more easily to effective monitoring than does physical communication. The key is to document, monitor and manage conflicts of interest fairly and effectively.

Specific issues in FICC markets: conflicts of interest and information flows

Q13

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

Potential conflicts of interest are already addressed by investor protection rules under MiFID II/R and directives of MAR. Furthermore, periodic assessment and review of conflicts of interest policy and taking all reasonable steps to address any deficiencies, as required by MiFID II/R, should also help manage any potential vulnerabilities.

We believe that such conflicts of interest policy will require periodic reviews (as is the case with all other policies) in order to ensure that it remains current with business changes, needs and requirements.

Disclosure of potential conflict of interest in certain instances is also considered a mechanism by which any future vulnerabilities and risks are best managed. When a conflict of interest must be disclosed, it is important that the disclosure does not affect adversely any of the parties involved. This may be the case if the *actual* conflict is required to be disclosed, as opposed to the *type* of conflict. In some cases, only a general disclosure that there might be a conflict is made because specifying the nature of the conflict would compromise one of the parties involved.

It should be noted that provisions exist for situations where internal structures and controls may not prove adequate. For instance, Article 25 of MiFID II/R stipulates disclosure requirements when internal structures are not sufficient to prevent conflicts of interest in investment research. A number of firms currently provide disclaimers on their webpage as tools for conflicts management. When disclosure of specific conflicts of interest is required, such disclosure should clearly state that the organisational and administrative arrangements established by the investment firm to prevent or manage that conflict are not sufficient to ensure, with reasonable confidence, that the risks of damage to the interests of the client will be prevented.

As a general principle, any changes to existing controls should be implemented across all market participants. It is, however, important to first define what types of communication are appropriate and in what forms. It is entirely possible that different firms may have evolved different models to effectively support their businesses.

There should be clarity around acceptable and unacceptable forms and medium of communication among market participants (please see our response to Q27 for construction of a unified, global Codes of Conduct framework). For example, market participants should be aware of their respective customer category and what services and protections each category entitles them to. This will allow market participants to be well-informed and establish equitable parameters for information sharing. Market participants are therefore, in a better and more informed position to decide if they wish to change the customer category.

Specific issues in FICC markets: competition and market discipline

Q14

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

Instinctively, we support competition in markets as it will, in general, enable the promotion of fairness and effectiveness of the overall framework. The asset classes and sub-asset classes in FICC have individual market characteristics making it harder to establish such relationship. For example, FX spot is a truly global market and certain segments of fixed income may be global while others more local in orientation. Such variation in market orientation in individual FICC segments is a function of a host of factors which includes applicable regulation, buyer appetite, currency, etc. Similarly, there are certain commodity products which exhibit a more local orientation although it will be fair to say that commodities market, as a whole, is largely global.

Competition must be considered along with suitability of market participants and financial capacity (e.g. capital) to meet risk standards. Some interdealer venues make certain requirements such as restricting membership to credit institutions and financial services providers, or minimum liable equity capital to become a clearing member to guarantee the suitability of the liquidity provider.

We, however, note that efforts aimed at enhancing competition should not lead to unintended consequences such as reduction in overall market standards or risking financial stability.

As discussed, in our responses to Q10 and Q12, in the commodities context we believe the current rules, as they apply to regulated firms, are sufficient. However, as acknowledged in Section 2, paragraph 11 of the Consultation, there has been a shift in concentration of commodities trading from "the major investment banks to vertically integrated commodity firms, combining both a physical business and a trading arm", and which may be unregulated. In our view, entities undertaking similar or analogous activities should be regulated in a consistent manner and standards and market practices should apply uniformly to the relevant activities, regardless of the nature of the market participant.

Some markets are very local – for perfectly legitimate reasons to do with the issuer and investor communities which are present, and local rules, regulations, market and business practices and customs. On the other hand, unnecessary fragmentation can be detrimental to competition and we again refer the Authorities to the AFME CMU Paper.

Specific issues in FICC markets: promoting effective competition through market forces

Q15

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

The FICC markets with which we are familiar include a healthy degree of competition. Please see our response to the FCA's Wholesale Sector Competition Review[16].

Competition in the FICC markets helps them function effectively. Transparency and competitiveness will also be enhanced as MiFID II/R aims to impose data and reporting requirements. It is important to note here that the existence of products and markets with OTC characteristics does not in and of itself suggest that transparency is lacking. Again, transparency in such markets is facilitated in part through the initiatives mentioned above.

Several examples of pricing data transparency, as cited below, contribute to a more competitive framework.

- In relation to electronic platforms, it is common to trade corporate securities with access to over one hundred market makers displaying quotes on trade platforms like Bloomberg on a regular basis on a significant number of bonds.
- In case of the FX spot market, where it is estimated that up to 90% of trading is electronic, pricing is available through multiple dealer platforms, single dealer platforms, retail providers as well as through channels such as Google or Yahoo Finance.
- Investors, in general, may have more pricing data available to them than the dealer market participants as they receive prices from multiple providers.
- AFME Post Trade Transparency Initiative.

Specific issues in FICC markets: promoting effective competition through market forces

Q16

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

There are examples in the US where platforms have influenced the liquidity, and therefore level of competition of FICC products. In case of fixed income, the TRACE reporting system in the US allows disclosure of post-trade data with appropriate price and volume deferrals which MiFID II/R aims to harmonise. Volume deferrals have been extended significantly for block trades in order to facilitate provision of liquidity and competition in market making.

Some other industry initiatives can also be examined to evaluate their likely impact on competition in the wider financial markets. In this respect, IOSCO's Task Force on Cross-Border Regulation (established in June 2013) and the IOSCO Cross-Border Regulation Consultation Report contain useful perspectives as well as detailed background and findings.

[16] Available on http://www.afme.eu/WorkArea/DownloadAsset.aspx?id=11860

We are also cognisant of industry submissions[17] in response to this consultation, which outline some useful case studies on the potentially anti-competitive impacts of cross-border regulation that drive market restructurings, in particular: the SEF trading requirements, margin requirements for uncleared trades under the BCBS[18]/IOSCO "Final Framework", and reactive bank restructuring under the Volcker Rule.

Specific issues in FICC markets: promoting effective competition through market forces

Q17

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

Going forward, market discipline will be more clearly enshrined in regulation (for example, MiFID II/R and MAR) than it was previously, such that participants will be obliged to comply with the higher standards.

Certain features of the fixed income market clearly establish basis for sound market practices. In the primary Eurobond markets, certain text (such as ICMA[19] Primary Market Handbook) has established an industry consensus around good practices regarding matters such as transparency and timeliness.

Sound market practices can also be established through a unified, global Code of Conduct framework that allows for appropriate regional variances in operational practices and consists of high-level principles that should be applied to all market participants. Specifically within FX, there exist central bank Codes of Conduct, which have been established through the Central Bank FX committees. There also exists the ACI Model Code, all of which are illustrated on page 39 of the Consultation. The opportunity now exists to consolidate such Codes of Conduct in order to promote a globally consistent standardised set of market practices that allow for appropriate regional variances in operational practices. The introduction of increased surveillance and enforcement measures by the authorities under MiFID II/R and MAR will also strengthen market discipline. This will be supported by compensation claw-back and deferral rules that thwart the 'jump-institution' culture. See also our answers to Questions 27 and 36, and the importance of culture and "tone from the top" applying throughout an organisation.

[17] (i) Cross-Border Regulation Forum submission on 28 May 2014 (third submission contained on http://www.icsa.bz/ under 'Library' and then 'News'), (ii) GFMA and JFMC Letter to IOSCO Regarding Global Regulatory Coordination submission on 30 May 2014 (Further details available on http://www.gfma.org/correspondence/item.aspx?id=599#sthash.rLafHUfz.dpuf)

[18] Basel Committee on Banking Supervision

[19] International Capital Market Association

Specific issues in FICC markets: promoting effective competition through regulatory and legislative initiatives

Q18

In what ways might competition in any of the key FICC markets usefully be addressed by competition authorities (eg by assessing the state of competition in relevant markets)?

The FCA has begun to turn its attention to competition in the wholesale sector: the Call for Inputs in 2014 as part of the Wholesale Sector Competition review and the expected announcement in early 2015 of the first wholesale market study will help identify areas where competition may not be working effectively. It is important that the effect of the current initiatives is evaluated after the market has substantially absorbed the impact of these changes. This will prevent contradictory initiatives and enable an objective analysis of the gaps and shortcomings which need to be plugged through further intervention. In this context, we would like to particularly note the Consultation's observation in section 5.2.3 which states "the Review is nevertheless conscious of the risk of unintended consequences." In our view, any premature intervention is likely to produce the unintended consequence of creating competing initiatives that could undermine and possibly confuse the desired objectives.

Specific issues in FICC markets: promoting effective competition through regulatory and legislative initiatives

Q19

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

The FICC markets have recently witnessed a significant number of initiatives and interventions that aim to improve overall functioning of the market. As some have not yet been fully implemented (such as MiFID II/R), it is important that the effect of the current initiatives is evaluated after the market has substantially absorbed the impact of these changes. This will prevent contradictory initiatives and enable an objective analysis of the gaps and shortcomings which need to be plugged through further intervention. Supported by existing data that the Authorities have for risk monitoring, potential risks that do not exist currently can be identified. This approach is not intended to oppose needed regulation but, rather, to recognise the multitude of initiatives that are filtering through the system whose impact has not been fully established yet. Any steps to widen regulation to include products for which they have not been designed need to be considered carefully as these could have the unintended consequences of disrupting established and well-functioning market systems. For instance, current derivatives regulation has not been designed for the FX spot market, and its application to the FX spot market is likely to cause disruption to the global payments system, which in itself will impact the real economy.

We urge the Authorities to take care to ensure that conflicting or competing initiatives do not undermine overall objectives. Any initiatives should not only be clear in terms of their actual scope and boundaries, but also apply consistently across jurisdictions and in line with applicable legislation. Initiatives that straddle asset classes in FICC markets need to be closely

coordinated and adopt common approaches, supported by a strong regulatory culture of surveillance and enforcement, while always ensuring that they are appropriate for each of the asset classes that they cover. Furthermore, initiatives need to enable cross-border flows by taking into account the local and global orientation of individual asset classes in the FICC product spectrum. We believe adherence to these principles is one of the greatest challenges of the successful implementation of any initiative that aims to change market practices or behaviour of market participants.

Lastly, we remain concerned that the business model of and competition amongst some market participants (such as market makers), who support market liquidity, is at risk through future proposals by the authorities that increase fixed and operational costs. Examples of such are increased costs as a result of proposed transparency requirements as per MiFID II/R; increases in capital, liquidity and leverage requirements; restrictions on holding inventories in response to Bank structural reforms such as Volcker and European rules; requirements to execute through venues where high frequency traders have better access than genuine customers; and inconsistent national regulatory regimes with extraterritorial impact being applied to global markets. These challenges collectively impact the business model of traditional market makers resulting in a number of banks reducing their inventories.

Specific issues in FICC markets: promoting effective competition through regulatory and legislative initiatives

Q20

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

We believe that market participants employ constant innovation that allows them to compete better in the marketplace. Ensuring competition frameworks are upheld is vitally important to all market participants and hence, we believe that such frameworks are both appreciated and understood. The Consultation, however, notes that under 5.2.3 para 14 "Evidence from recent misconduct cases suggests that the potential applicability of this law to FICC market structures and practices may be under-appreciated." We are of the view that a possible lack of consistency in applicable regulation may result in different forms of competition frameworks being applied at firm level as well as by individuals.

Specific issues in FICC markets: benchmarks

Q21

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

We believe it is too soon to say.

It is recognised that initiatives remain in progress and the regulatory structure is generally in flux. At this stage, coordination and consistency of efforts that are in progress are more important than undertaking new initiatives.

We believe that the UK has imposed a comprehensive framework around certain critical benchmarks and that no additional benchmarks (beyond the ones already proposed by the UK authorities) need to be brought into the scope of the regime at this time.

However, the proposed EU Benchmark regulation raises great concern related to global consistency and the appropriate proportionality of any benchmark regulatory regime. Any disruption in the availability of key benchmark as the result of fragmented regulation risks creating instability.

There is presently an ongoing discussion globally with market participants and policymakers as to whether the administration and governance of EURIBOR and LIBOR can be incrementally improved such that they remain critical points of reference and whether a new risk free rate can and should be devised to transition away from over-reliance on the IBORS. There needs to be global industry and regulatory cooperation and agreement to resolve these issues to enhance confidence in our markets.

We remain supportive of the IOSCO Principles which have created a global framework and we believe the industry is embracing these principles satisfactorily. However, it will take time for administrators to implement and document the various elements. We encourage greater global cooperation and discussion to further expedite the global adoption of the IOSCO Benchmark Principles.

Specific issues in FICC markets: benchmarks – industry level measures

Q22

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

We believe efforts should remain focused on strengthening integrity of and market confidence in benchmarks through robust governance, transparency and methodology – rather than attempt to directly reduce reliance through regulatory or other means, noting that benchmarks provide a source of transparency to investors as well as liquidity and standardisation.

Robust risk management practices, investor education, and product disclosure are also instrumental in ensuring the appropriate use of benchmarks. Both regulators and benchmark administrators could assist in educating market participants and the public in this regard.

Specific issues in FICC markets: benchmarks – industry level measures

Q23

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

We believe the framework created by the IOSCO Principles for Financial Benchmarks incorporates all the elements necessary to strengthen confidence in benchmarks. It is particularly important that sufficient attention is given to the transitional measures of any local initiative.

However, by way of general comments, we would stress:

a) that divergent regional interpretations of high level principles and/ or divergent reforms and conflicting rules undermine the efficiency and effectiveness of the markets. Therefore, reforms should be coordinated internationally to ensure maximum consistency;
b) Legislators should be mindful that there is no 'one-size-fits-all' solution and it is vital that a full assessment of (i) the interaction between the benchmark and underlying, and (ii) the likely effect on market participants of any new rules, is made prior to the promulgation of new rules. For example, the IOSCO Principles explicitly recognise the role of expert judgment in the determination of benchmarks; and
c) If standards for submitters are too high or too onerous, fewer market participants will be prepared to comply - leading to small panel sizes and the accompanying risk of potential abuse. In many cases, regulatory compulsion is not necessarily the appropriate way to address this issue, and should only be used as a last resort and then only if it is clear that the firm in question has the necessary resources and expertise to contribute to the relevant index.

Specific issues in FICC markets: benchmarks – industry level measures

Q24

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

In our view, it is vital that the impact on the relevant market is assessed prior to the adoption of new rules, rather than after they have been adopted – even if this is before the implementation of the new rules. We strongly encourage the Authorities to work with the industry through formal and informal panels and working groups and to continue to build on the constructive engagement to date such as that under the FSB and the creation of the Market Participants Group to focus on reviewing the reform of Interest Rate Benchmarks.

Accordingly, we would welcome the establishment of an appropriately representative practitioner panel which could comment on proposed reforms before they are adopted. Given the heterogeneous nature of FICC asset classes (even within a specific category such as commodities), any panel would need to be specific to the relevant sub-asset class of the FICC product.

Specific issues in FICC markets: benchmarks – regulatory action

Q25

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

Consistent with suggestions within the IOSCO Cross-Border Regulation Consultation Report, we encourage IOSCO to enhance regulatory dialogue and coordination of national plans to implement and promote compliance with the IOSCO Principles. We believe that agreement on international principles should fundamentally be accompanied by a pragmatic discussion on the manner and timetable of national adoption. Such discussions are required in advance of and in concert with the release of principles with a focus on an outcomes-based approach to avoid cross-border conflicts. We would also be supportive of a FSB peer consultation to ensure that domestic benchmark initiatives adhere to, and do not conflict with, the IOSCO Principles.

Specific issues in FICC markets: benchmarks – regulatory action

Q26

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

We suggest that the core focus remains on critical benchmarks. We believe that any national regulation needs to permit for the recognition of third country benchmarks which can demonstrate adherence to the IOSCO Principles by way of a local regulatory and supervisory framework or an independent consultation in the absence of local regulation.

Specific issues in FICC markets: Standards of market practice

Q27

Are existing sources of information regarding standards of market practice across FICC markets globally:

(a) already sufficiently clear (or will be once current regulatory reform has concluded);

(b) sufficient, but in need of clearer communication or education efforts; or

(c) not sufficiently clear, requiring more specific guidance or rules to provide more detail or close genuine gaps?

We believe that (c), as per the question above, is applicable.

While significant work has been done in this area, codes are either very high level (like the Non-Investment Products Code), or negative, tending to state what is unacceptable rather than stating what is acceptable. There are many codes, some of which overlap in their coverage. We believe that this patchwork of codes is sometimes difficult to navigate.

We see benefit in developing unified, globally agreed Codes of Conduct frameworks, that allow for appropriate regional variances in operational practices, with high-level principles setting out both acceptable practices (including safe harbours) and unacceptable practices. However,

we recognise that it will take time to develop such codes and that there will be challenges in ensuring that these codes are detailed enough to be meaningful to the industry. We also believe that there should be some type of enforcement mechanism to reinforce adherence to these codes and industry will need to be closely involved in all stages of their development. In order to foster a culture of openness and frank discussion, we recommend that the Codes of Conduct regime be informed by discussions, coordination and agreement with regulators.

Additionally, we support industry Codes of Conduct as well as dynamic, regulator-endorsed market practice guidance, which address current grey areas of acceptable and unacceptable behaviour. The industry should have a mechanism for feeding through areas where guidance would be helpful. We support a renewed focus on the vitally important requirement for front office staff to know and understand these guidelines and to escalate a question if the facts fall into a previously undetermined or "grey" area. Such guidance will help provide greater clarity of understanding of evolving rules and principles. An independent body or group with the appropriate degree of expertise and knowledge regarding the FICC markets could play an important role in conjunction with industry participants in establishing such market practice guidance.

This does not suggest that the content of the codes will not evolve over time. It is understood that what was acceptable ten years ago may not be acceptable now. But, as set out in Box 7 of the Consultation, uncertainties exist around some trading practices, which are unhelpful.

In context of the FX market, regional committees have performed significant work historically around Codes of Conduct (along with operations best practices, legal documentation best practices, and the like). It is, however, noted that for a business which is truly global, the existence of inconsistent language, interpretation and level of detail is not helpful. There is, therefore, a need for more globally consistent language and also more guidance for all market participants.

Specific issues in FICC markets: Standards of market practice

Q28

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

We agree with the list included in the question and would add the need for specific training on specific FICC asset classes for FICC staff and the back office functions that support and control them. It can be misleading to think of FICC as one subject; the asset classes and the skill sets are different.

The FX market serves as a helpful example on this question.

FX is a principal based market with market participants taking on risk and providing liquidity - even if the risk is held sub-seconds before trading out of the position. FX is not an agency market where a market participant acts on behalf of the other in the marketplace.

The FX market has primarily evolved as a principal based model due to the requirement of end-users to physically move funds to effect international payments. Market makers, especially in times of stress, are able to absorb risk and provide stable pricing to end-users, thus allowing the continued performance of the global payments system. An agency market would be expected to show increased price volatility in times of stress, with adverse impacts on both end-users of the FX markets and the real economy.

Furthermore, there needs to be transparency for the market participants around their respective customer category and what services and protections each category entitles them to. This will allow market participants to be well-informed and establish equitable parameters for information sharing. Market participants are therefore, in a better and more informed position to decide if they wish to change the customer category.

It is not possible to predict in advance every situation that might arise. Please see also our answer to Question 27.

Specific issues in FICC markets: Standards of market practice

Q29

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

Please see our response to Q27.

Also, there are a number of useful FCA publications and practices at present – Market Watch, FCA speeches, FCA seminars, practitioner panels, thematic review outcomes etc. The difficulty with these media of communication is often that, while they reflect current FCA thinking, in many instances, the industry will have had little opportunity to influence their content. The industry may well disagree and/or need time to implement changes and training to ensure compliance. Retrospective regulation is as unhelpful as uncertainty of regulation, or lack of global consistency of regulation, or indeed of Codes of Conduct.

Specific issues in FICC markets: Standards of market practice – will these uncertainties be dealt with by current reforms?

Q30

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

Please see our response to Q27.

Specific issues in FICC markets: Standards of market practice – will these uncertainties be dealt with by current reforms?

Q31

Should there be professional qualifications for individuals operating in FICC markets? Are there lessons to learn from other jurisdictions — for example, the Financial Industry Regulatory Authority's General Securities Representative (or 'Series 7') exam? Can the industry help to establish better standards of market practice?

Annual appraisals of individuals should reconfirm that his/her knowledge thereof is up to date, including minimum annual Continuing Professional Development (**CPD**) updates. Certified Persons' (under the new "Strengthening accountability in banking" regime) annual certification should include having completed the CPD; Approved Persons' (under the current regime) continued assessment as fit and proper should be contingent upon their having completed the CPD.

Professional qualifications are generally a positive, both in terms of added knowledge and of professional standards that have to be adhered to. One way of focusing attention on professional standards could be to consider the reintroduction of exams on relevant regulation and codes to be passed by individuals before working in the industry and an on-going assessment to ensure competences is maintained. However, we are mindful that there is limited empirical evidence that jurisdictions which make such exams mandatory, have significantly higher standards of behaviour. In any case, we do not think it appropriate to require formal professional qualifications (analogous to those required for a solicitor or accountant, etc.) to work in the FICC markets. The markets are very different and the roles played by individuals so disparate that it would be difficult to establish them.

The industry would certainly be prepared to help to establish better standards of market practice, but any such standards need to be internationally agreed, and not just restricted to the UK.

Specific issues in FICC markets: Standards of market practice – can the industry help to establish better standards of market practice?

Q32

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

Please see our responses to Q27 and Q31.

Specific issues in FICC markets: Standards of market practice – can the industry help to establish better standards of market practice?

Q33

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

Given these codes are likely to be asset class specific, a sub-group could be created to revisit this periodically. Customisation for asset classes can be achieved by training, as set out in our response to Q27 earlier, against a clear set of do's and don'ts.

Laying down basic standards of behaviour and keeping unscrupulous individuals out of the industry are at least as important as detailed codes and training. This requires rigorous background and reference checks, assisted by the regulator.

We have said, in our response to the PRA[20]/FCA consultation paper on "Strengthening Individual Accountability in Banking", that the discontinuation of the FCA register is likely to have a negative effect on standards across the industry, in part because of a reduction in transparency (for the industry, consumers and regulators) of many individuals' conduct history. Under the proposed regime, there will no longer be any requirement that all individuals performing client facing and other important functions be pre-approved on the strength of high quality and extensive information held by the FCA.

Instead, the proposed Certification Regime rules require an individual's fitness and propriety to be self-certified by firms. Although firms will be able to require the provision of references from other authorised firms, the information will be very limited i.e. to circumstances of dismissal or suspension, formal warning or remuneration forfeiture. Without the provision of substantive references, overall standards are likely to decline.

Industry needs the help of the regulators in the certification process, as the regulators can retain information that a prospective employer does not have access to; the proposed rules make no provision for the continuation of valuable conduct history records. Moreover, the absence of a requirement on firms to send deregistration filings to the FCA explaining the reasons for an employee's departure means that important information on individuals will no longer exist.

One option is that each of the PRA and FCA could continue to hold information about individuals and raise particular concerns it has about the certification of an individual with the relevant firm. This could be done by the relevant regulator notifying the firm that in light of the information available to the regulator it considers that enhanced due diligence is required before the firm makes their decision to certify, or, in exceptional circumstances, by use of a right to veto a firm's decision to certify an individual.

[20] Prudential Regulation Authority

The foregoing also applies across jurisdictions. Regulators need to exchange information, so that it should, as a generality, be extremely difficult for individuals terminated by banks for gross misconduct to find positions elsewhere in the industry globally. That is not the case at present.

Specific issues in FICC markets: Standards of market practice – should the scope of regulation be extended?

Q34

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

We believe that FCA Principles for Businesses should apply generally. However, the Principles should not be interpreted to imply that Eligible Counterparties trading with each other owe one another duties as though they were trading with retail or professional counterparties. The whole purpose of the MiFID II/R client classification regime is to classify clients into different categories of expertise, requiring differing levels of protection. Retail clients should continue to have the highest level and Eligible Counterparties the lowest.

Specific issues in FICC markets: Standards of market practice – should the scope of regulation be extended?

Q35

Are there any financial instruments that should be brought more fully into the scope of regulation in order to improve the fairness and effectiveness of specific FICC markets? For any instruments proposed:

(a) what protections does the current framework provide;

(b) what gaps remain of relevance to fairness and effectiveness; and

(c) what is the cost/benefit case, bearing in mind the Consultation's Terms of Reference as set out in Section 1?

We do not believe so.

We believe that proper behaviour should apply irrespective of the asset class. But any expansion of the regulatory perimeter should be treated with caution. If the UK acts alone in this matter, business will be lost to other financial centres with lesser regulation. Similarly, regulation of FICC trading should cover not just entities and individuals who are regulated by financial regulators, but all who trade the products in question. Otherwise the regulated industry will lose market share to unregulated competitors.

Unlike the FX derivative products which are included in the G20 regulation[21], the FX spot market is likely to be most aptly monitored through a unified, global Codes of Conduct framework based on high-level principles that allow for appropriate regional variances in operational practices. These codes should be supplemented by dynamic market practice

[21] Dodd-Frank Act (**DF**), MiFID II/R - obligations include regulatory reporting, margin, clearing, pre and post-trade transparency and business conduct

guidance, developed by the industry and endorsed by the regulators, around products and associated practices where actual or potential conflicts of interest are most prevalent. Bringing FX spot market under the regulatory umbrella (DF, MiFID II/R, EMIR, FTT, CRD4[22] etc.) with a wide scope (covering regulatory reporting, margin, clearing, price transparency, business conduct) will potentially disrupt and undermine the effectiveness of the global payments system. We would like to further observe that FX spot is currently covered under the "Strengthening accountability in banking" regime, and it could be argued that it is more effective to oversee and hold accountable the individual/institution rather than the product itself.

Specific issues in FICC markets: Responsibilities, governance and incentives

Q36

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

Publicly available information is limited to decision notices published by regulators. Regarding recent FICC market abuses, criminal proceedings may be pending, and there is undoubtedly much information that has not been made public. Therefore, this question is difficult to answer.

Based on the information that we do have, it seems clear that behaviour has taken place which was absolutely unacceptable and we fully support measures designed to further improve conduct across the sector.

There has over the last few years been an emphasis on "tone from the top". This of course is critically important, and CEOs and boards of banks have repeatedly stressed the need for ethical behaviour. However, it is equally important for such ethics and standards of behaviour to form an integral part of the culture of the entire organisation at all levels, from the very top to the most junior staff who do not interact directly with CEOs and boards. Careers and conduct of more junior or mid-level employees, as with many large and complex organisations, are more directly influenced by their line managers than by CEOs and boards. Implementing such a change in culture is a long term project: New City Agenda, in their recent report on culture in retail banking, stated that the process of changing culture will take a generation. The same is likely to be true in FICC; although much has been done, much remains to be done.

By way of example of what has already been done, under the CRD4/CRR[23], firms are required to have remuneration policies in place that incentivise long-term performance and align risk taking and rewards. These requirements are extensive and will ensure that remuneration policies foster sound risk management and avoid incentives for excessive risk taking and short-termism.

[22] Capital Requirements Directive
[23] Capital Requirements Regulation

The requirements will be applied to the category of Material Risk Takers (**MRTs**) within institutions, identified through a number of quantitative as well as qualitative, criteria. Under these EU rules, a significantly greater number of employees will generally be identified and subject to the provisions of the UK's Remuneration Code than in the past. Their scope of application is therefore, broader than the previous scope of the Code and should therefore be more effective in incentivising appropriate behaviour in those individuals who can materially impact a firm's performance.

Under the CRD4/CRR, the remuneration structures of MRTs must be designed to reinforce the alignment of awards with risk taking. This is achieved by requiring that no less than 50% of variable remuneration is granted in non-cash awards, that at least 40% (and in the UK 60% when variable compensation exceeds £500k) is deferred for at least 3-5 years. As a result, a significant proportion of variable remuneration is deferred over an extended period of time, subject to "malus" (see paragraph below), and paid in the form of equity, linking remuneration to firm performance. These reforms are on top of the EU bonus cap, which limits variable pay to one times fixed pay (or two times fixed pay with shareholder approval).

Moreover, the UK is going further than EU rules, introducing the most stringent remuneration regime in the world. For PRA regulated firms, variable remuneration is also subject to ex-post performance adjustment (i.e. claw-back) for a period of 7 years after the award has been granted. This means that not only do MRTs have to wait for their awards to vest and be paid out (a period during which their awards can be reduced should any material issues come to light - known as the "application of malus"), but even awards that have vested and been paid out can be recovered. The PRA is also considering lengthening the period for deferral of remuneration.

Some of these rules are new (for instance, the EU Regulation on identifying MRTs was adopted in March 2014), or are yet to be fully implemented. Firms have therefore been undertaking significant educational programmes to ensure that all employees who qualify as MRTs understand the implications in terms of their remuneration structures. We can therefore expect to see the effect of these regulatory initiatives to better align risk and rewards bed down over the coming months and years as individuals become more cognisant of their consequences. It is important to allow these measures to take effect before introducing yet another layer of regulation on top.

Specific issues in FICC markets: Responsibilities, governance and incentives – firm-wide initiatives to improve incentives and governance

Q37

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

We agree, in general, but would point out that none of this is FICC-specific; it applies to capital markets generally across all market participants. Moreover, a number of the new remuneration

rules implemented this year (as highlighted in our answer to Q36) have not yet had a chance to take full effect.

It is also worth noting that the constraints imposed on variable remuneration by the CRD4 bonus cap mean that many of the tools recognised as being useful to better align behaviour and rewards may become less effective in terms of risk management. The bonus cap is therefore a counterproductive measure.

Specific issues in FICC markets: Responsibilities, governance and incentives – market-wide initiatives to align market conduct, incentives and governance

Q38

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

AFME strongly supports the objectives of raising standards in the banking sector and rebuilding public trust. The Banking Standards Review Council (**BSRC**) has an important role to play in this regard, but its remit only applies to its members, and is ambitious in what it has set out to achieve, particularly in terms of its scope and getting the body up and running quickly. A step by step approach to building the initiative, starting with professional standards in retail banking, will ensure that the BSRC is credible and ultimately a success. The BSRC's ideas on conduct may well contribute to the debate, and AFME would welcome all constructive contributions thereto from any source, but the activities conducted by retail and wholesale banks are very different, and these differences need to be taken into consideration.

Specific issues in FICC markets: Responsibilities, governance and incentives – regulatory initiatives to improve governance and incentives

Q39

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

We would respond in the affirmative to the second question above, although we have reservations about the likely effectiveness of certain aspects of the Senior Managers and Certification regime (part of "Strengthening accountability in banking") in this regard. Our detailed comments can be found at the web link below:

http://www.afme.eu/Documents/Consultation-responses.aspx

Please also refer to our response to Q33.

Specific issues in FICC markets: Surveillance and penalties

Q40

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

Please refer to our response to Q41.

Specific issues in FICC markets: Surveillance and penalties – firm level surveillance

Q41

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

There is a need to distinguish between on the one hand electronic surveillance systems, that look at email, chatrooms, SMS and phone conversations; and on the other hand automated monitoring systems, that look at trading patterns.

Regulators set great store by the latter, but we believe that more suspicious transactions are identified because an individual reports something that he/she thinks is suspicious, than are identified by automated trade monitoring systems. Not all products are susceptible to automated trade monitoring systems, and manual monitoring may well be a more cost effective way of proceeding for many products. Compulsory automated trade monitoring systems across all products should be avoided as disproportionate, and as creating an additional barrier to entry.

We believe, however, that electronic surveillance systems of communications (phones, email, SMS, chatrooms) do add value because individuals need to believe that the risk of being caught, banned and imprisoned will outweigh any likely financial gain. However, probably not even the most sophisticated systems on the market would have caught all the recent high-profile wrongdoers, as firms' systems cannot always see the whole picture of a transaction.

Specific issues in FICC markets: Surveillance and penalties – firm level penalties

Q42

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

We believe these already exist, as do whistleblowing procedures.

Specific issues in FICC markets: Surveillance and penalties – firm level penalties

Q43

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?

Suspicious transaction reporting already exists and is being strengthened by the provisions in MiFID II/R. It is not clear what additional reporting is envisaged by this question, or would be helpful. However, the suspicious transaction reporting forms, and also the suspicious activity reports used for money laundering, are not suitable if there is no actual transaction to report but only a suspicious circumstance. The forms need to be improved, and greater provisions made for oral and informal reporting of suspicions.

Specific issues in FICC markets: Surveillance and penalties – regulatory level surveillance and supervision

Q44

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

Yes, except there have been several examples of retrospective rule changing, as the FCA has itself accepted. In a principles-based regime rules will always evolve, but this is best done via agreed practices, consulted on in advance and not applied retrospectively. Please refer to our response to Q27.

Specific issues in FICC markets: Surveillance and penalties – regulatory level surveillance and supervision

Q45

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?

There may be scope for improvement, but any such proposal should be made subject to rigorous cost-benefit analysis of the impact on systems, which will be significant.

Specific issues in FICC markets: Surveillance and penalties – regulatory level penalties

Q46

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

Regulators should focus regulatory enforcement action on those cases involving real intent to manipulate markets. These should normally be the subject of criminal proceedings. Stamping out deliberate unethical practices – which can generally be prosecuted as fraud or conspiracy - is of paramount importance. It must no longer be the case that individuals feel it to be worth the risk to participate in such practices.

Cases of negligence or innocent wrongdoing, by contrast, should be dealt with summarily by warnings and obligations to undergo training. Regulators should not spend time and resources on these matters.

Specific issues in FICC markets: Surveillance and penalties – regulatory level penalties

Q47

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

While early intervention can be employed in greater number of instances, risks exist in doing so unless the facts are absolutely clear. We believe this power is, in general, more appropriately used in retail markets than in wholesale markets.

Specific issues in FICC markets: Surveillance and penalties – regulatory level penalties

Q48

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

We do not believe that there is a need to further widen or strengthen such criminal sanctions as long as the existing sanctions are employed in appropriate situations to control misconduct. Please also refer to our responses to Q46 and Q49.

Specific issues in FICC markets: Surveillance and penalties – regulatory level penalties

Q49

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?

We support the concept of criminal sanctions for market abuse. We question the need for more criminal offences, just as we question the need for more regulation. We believe that existing criminal offences (such as fraud and conspiracy) cover the practices that need to be stamped out.

On behalf of the members of AFME and GFME we thank the Authorities for the opportunity to comment on the Consultation and hope that our response will be of assistance. If the Authorities have any questions or would like any more information, please could they contact the undersigned.

Yours faithfully

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Annex 1

AFME represents a broad array of European and global participants in the wholesale financial markets, and its 197 members comprise all pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME was formed on 1 November 2009 by the merger of the London Investment Banking Association and the European operations of the Securities Industry and Financial Markets Association. AFME provides members with an effective and influential voice through which to communicate the industry standpoint on issues affecting the international, European and UK capital markets. AFME is the European regional member of the Global Financial Markets Association (GFMA) and is an affiliate of the U.S. Securities Industry and Financial Markets Association (SIFMA) and the Asian Securities Industry and Financial Markets Association (ASIFMA). AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

GFMA brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. AFME in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, please visit http://www.gfma.org.