AXA Investment Managers Trading & Securities Financing department's response to the Fair and Effective Markets Review Consultation Paper.

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AXA INVESTMENT MANAGERS

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

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

AXA IM Trading & Securities Financing department ("AXA IM TSF") fully supports The Investment Association response to this consultation paper.

However, we would like to highlight that this is for all areas of the market whole sale and retail and the fact that as experts in our markets we should perform better and have access to better pricing than smaller players.

Moreover, in table C, we would add « control » to the list of proposed characteristics of "Fair".

A framework for evaluating fairness and effectiveness

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

FICC market abuse focus has been centered on the structure side of late WMR LIBOR and the principles governing them and therefore we believe the market micro structure and discipline have been in that. We also believe that competition and market microstructure are important factors and that surveillance and penalties should also be reinforced in light of recent series of FICC market abuses.
We also want to highlight new issue process as an area for review.

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?

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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?

Market microstructure partially increases effectiveness of FICC markets (more Request For Quotes – "RFQ" platforms on different markets) but the cost of access can prevent some market participants from using them as it requires financial, technological and human resources. Moreover, despite some RFQ platforms provide pre-trade prices, those prices can be very different from execution prices which does not give a fair picture of the market.

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?

We believe that regulation only goes part way to help inefficiencies and the unintended consequences could lead to more issues than improvements.

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?

Despite the cost of access, there is no reason why the market should not become more electronic but Mifid II may not necessarily benefit more E-business – we saw that with EMIR and swaps. We think reach is a good thing and that order books, Execution Management System capability and matching will all help reach and connectivity. This could also make the market more transparent or give us more transparency on inventory.
However, as all market participant can't access to all e-trading platforms, the numerous initiatives contribute to market fragmentation where interests should be centralized on a common platform.
Finally, buy-side participants are used to be price-takers where they would have to shift to a price-making model in order to be less dependent from sell-side participants to access to liquidity.

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?

AXA IM TSF endorses The Investment Association view. We believe it is highly desirable as the fixed-income primary market lacks transparency towards buy-side participants and standardization. This initiative should enhance secondary market liquidity. However, it will not necessarily have the buy-in from the ACT and the issuers generally speaking due to the flexibility and liability matching needs.

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?

Yes it should be totally transparent.

Quality of new issues details must be improved by sell-side participants who have all the information available on ISSUENET but are reluctant to move quickly on that end.

Non publication of interests during the book building as well as final allocations is a great lack of transparency for the primary market. Usual argument by sell-side participants to fight against that proposal is that it would result in the investors inflating their interests. However, we believe that first level controls within buy-side participants together with second level controls at the regulators level through a centralized system or through a systematic reporting by all investors could help improve transparency in new issues.

In foreign exchange:

Q8: Are there risks associated with internalization and last look practices? Are there barriers preventing increased pre and post-trade transparency in foreign exchange markets?

We do not see any risks from internalization of FX.
Firstly, banks have been internalizing flow for years and larger corporates as well as asset managers should be looking to replicate this process where they can trade at or near mid. These are gaining more momentum : for example, State Street have launched True Cross to replace WMR fix orders and Integral have also launched a product which internalizes a company's business and decreases the market foot print. There are no barriers preventing either more pre or post trade transparency as FX does not carry the same risk as illiquid Fixed-Income instruments with regards to these area and risk is transitioned far quicker.

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

It could decrease bank liquidity and the liquidity posted on broking systems such as EBS. Banks on the whole don't want to take fix orders as they are fearful of implications either from making a profit or sharing information.

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?

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Regulatory measures:

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

New issue market needs to be regulated internationally to avoid New Issues arbitrage i.e. issue in a country away from transparency requirements. Also pricing and firmness of pricing remains an issue.

Market abuses on Fixed Income secondary market could arise, for example, from stream prices not updated or best bid provided by a counterparty while it is a seller (and vice versa).

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?

Again information around New Issues can conflict a firm if the information is not public. Also opening up and giving traders too much information and that being used against us in the market without any way of clearly demonstrating the fact is market abuse. Mis-advertising to get that enquiry is also very poor and often done.

Front running can happen on the secondary market in the following circumstances :
Market information available on buy-side traders' screen shows that a certain sell-side participant provides the best bid. But when the buy-side participant actually requests a quote to it, it quickly changes the price to a less interesting one. Then knowing the buy-side participant intention, it can front run it.
Therefore, we believe more stringent controls on sell-side prices displayed on market information systems would be beneficial to market discipline.

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

A clear set of principles not rules should be applied to the market and each market practitioner should be held accountable and fined for not complying or flouting them.

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.

Competition will naturally lead to fairness and effective markets as unruly participants could be eased out but it did little to erase collusion in FX or fixing in the LIBOR market. The risk in concentration could be manipulation, prohibitive bid offer spread, monopoly, illiquidity and liquidity makers gaming the market.

Promoting effective competition through market forces

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

There are 35+ initiatives that think that they can re align this issue. Only a few will do that but they will be successful. Order books like NYSE BondMatch, Liquidnet for matching, Neptune, Tradecross etc will all play their part.

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?

Equity fragmentation is one which springs to mind and the problems that has caused as well as dark trading.
On the positives, we believe that spreading the FIX protocol on Fixed Income market could be a strong improvement, as it proved to be on the Equity market.

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?

AXA IM TSF endorses The Investment Association view. We also believe that it is not effective enough given the back drop of the last few years - this has been a firm culture rather than a market dis-function but needless to say there are still many disciplined principled participants in the industry which will be helped by a clear set of market principles and some consequences for breaking them.

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)?

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

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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?

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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?

AXA IM TSF endorses The Investment Association view. We believe they are steps in the right direction as LIBOR has moved on and WMR has seen some benefits from the FSB recommendations – that said the issue is more with the industry being overly reliant on benchmarks for asset allocation and valuation than the actual benchmark and the benchmarks were never designed for such massive concentration. Any initiative to make them more credible would be beneficial.

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

AXA IM TSF endorses The Investment Association view on this important question and we would support an industry evaluation of the use of benchmarks and the reliance on them.

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

Wider and more random selection of composite data and actual executed levels for more benchmarks and more contributors. The governance needs to be oversight of trades backing those feeds.

Q24: Should there be an industry panel to discuss benchmark use and design with the aim of assisting industry transition?
Without a doubt as well as a governance committee should be set up.

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

AXA IM TSF endorses The Investment Association view.

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

AXA IM TSF endorses The Investment Association view

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?

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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?

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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?

B and, if not sufficient, C.

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?

AXA IM TSF endorses The Investment Association view.

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?

We believe it has to be an industry effort, with a focus on new entrants as well as a regular training for traders.

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?

AXA IM TSF endorses The Investment Association view. Besides, we believe they play an educational role to provide (i) a better understanding of how individual behaviors can impact markets and (ii) a better knowledge of the other side constraints.

Q33: How would any code tackle the design issues discussed in Section 5.4.3, ie: 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 customize it for individual asset classes?

AXA IM TSF endorses The Investment Association view. In addition, the designers would need to work with all types of market participants and make sure they consult correctly, give one of the authorities power over it and to ensure the standards are workable, fair and effective, not standards for standards sake. The principles could be tailor made quite easily.

Should the scope of regulation be extended?

Q34: In the context of implementing MiFID 2, which of the FCA Principles for Businesses should apply in relation to MiFID business with Eligible Counterparties?

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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 FICCmarkets? For any instruments proposed: (a) what protections does the current framework provide; (b) what gaps remain of relevance to fairness and effectiveness; and (c) what is the cost/benefit case, bearing in mind the Review's Terms of Reference as set out in Section 1?

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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?

AXA IM TSF endorses The Investment Association view.

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?

AXA IM TSF endorses The Investment Association view.

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?

AXA IM TSF endorses The Investment Association view.

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?

AXA IM TSF endorses The Investment Association view.

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?

AXA IM TSF endorses The Investment Association view which states the following : "In order to strengthen the fairness and effectiveness of FICC markets, surveillance method must be strengthened, both by regulator and within the firms themselves. Firms should both build up stronger codes of practice, and ensure they are communicated to the wider workforce. If these codes of practice are sufficiently strong and well-defined, it will be easier to see where an individual's actions fall outside the best practice framework".

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?

AXA IM TSF endorses The Investment Association view.

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)?

AXA IM TSF endorses The Investment Association view.

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?

AXA IM TSF endorses The Investment Association view.

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?

AXA IM TSF endorses The Investment Association view.

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?

AXA IM TSF endorses The Investment Association view.

Regulatory-level penalties

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

AXA IM TSF endorses The Investment Association view.

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?

AXA IM TSF endorses The Investment Association view.

Q48: Is there a need to widen and or strengthen criminal sanctions for misconduct in FICC markets?

AXA IM TSF endorses The Investment Association view.

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 ?

AXA IM TSF endorses The Investment Association view.