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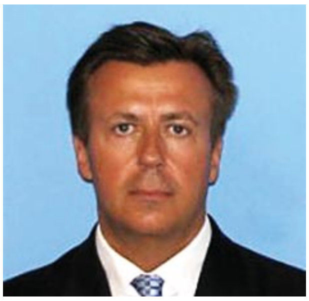
Marshall Bailey: The Ethical Banker

Marshall Bailey's appointment as ACI's full-time President comes at a critical time for members, especially those involved in trading businesses.

"Marshall's experience, strong ethical stance and leadership will help us forge a path with sell- and buy-side individuals and our regulators," says Eddie Tan, Chairman of the ACI Managing Board. "We conducted a year-long search and determined that we needed someone who can guide us through the challenges facing the industry, and who can work closely with the many facets of our Association. ACI has been a leader for many years with its Model Code and financial markets education and certification programs, as well as on FX operational matters."

Philippe Jeanne, Head of ACI Europe, adds: "Marshall's appointment was resoundingly endorsed by the ACI Regional Presidents, and by an incredibly strong majority of the ACI Councillors. We are excited to be moving into a period of strength and opportunity for ACI, especially given the challenges and conditions in the market place. We know the value proposition ACI can offer to market participants, and we are ready to help our clients, the general public and industry thrive in a way that addresses the concerns of all of our constituents."

On the sidelines of the ACI World Congress, *ACI Briefing* sat down with Marshall Bailey to discuss his role, his vision for the Association and the work that needs to be done over the coming months to take ACI forward.



ACI Briefing: What attracted you to the role of President of ACI?

Marshall Bailey: ACI is an organisation that says something important. The message it has is that our members stand for best behaviour in the marketplace and we have our best behaviour laid out in our Model Code. It isn't a lawyer's view of how things should be but the aggregate of the best thinking of practitioners in the market. That it has been endorsed and used by a number of central banks and FX committees globally speaks to the power of that message of good behaviour and best practice.

What I also really like about ACI is that it is a voluntary body of more than 13,000 dedicated members from more than 60 countries, which means it truly is a global organisation. These people are similarly-inclined not only to pursue best practice but to network and discuss ways of taking the industry forward, and challenge each other in their thinking.

I'm astounded by the commitment of ACI's members. They are dynamic, energised and they give their free time for the betterment of the industry. For me, joining ACI at this time in its history, and it has a long history, at a time when a strong, unbiased voice in the financial markets community needs to be heard, was an opportunity that was too hard to pass up. I genuinely believe that financial institutions that work with us and endorse our work are helping themselves and helping their clients.

If you want to instil a culture of best behaviour in banking and you want to prove to others that you are able to follow the best code in the market, joining ACI, putting your members through the education programmes and having them ratify the Model Code is an obvious way to go.

AB: What is your vision for ACI and how do you plan to move forward?

MB: My vision is being solidified as I work with members of ACI. I report to the Managing Board and my plan is to work with the leadership of the Association to execute on our plan. So, while I have very strong ideas about what is needed and how we can best help the financial markets community, how we can best position ourselves and our membership, I need to make sure that I am serving our global membership, and follow the lead that we have set up here in Berlin.

The plan and vision will include professionalising our contact with the community, in other words how we work with traders, heads of trading desks and professional market participants. We are going to be heavily focused on our Model Code and on the work that the Board of Education does in providing certificates and diplomas, and we are going to help the financial markets to deliver a standard that upholds the highest values for the industry.

continued on p.2 ▷

Contents

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ACI Briefing is published by:
PROFIT&LOSS
IN THE CURRENCY & DERIVATIVE MARKETS

Marshall Bailey Continued from p.1

AB: Do you see ACI as a lobby group?

MB: While I think we have an important message and voice that will be heard, I don't believe that lobbying on regulation, for instance, will be a central theme for us at this point. If we stick to our strengths we will not only grow rapidly in this environment with our membership expanding in important ways, but we will be able to determine how much time we have to engage in lobbying and for whom we might want to speak. It is important to remember that we don't only represent banks, but also other participants such as clients, and we bring a voice that has best-practice as a constant theme.

AB: Will your approach be proactive or reactive to events?

MB: Definitely proactive! Just like the global financial crisis in 2007 helped banks to better understand their own balance sheets and help the industry to improve the culture in banking and look at liquidity in different ways, I think that the question around LIBOR and the questions being raised around the FX fixes will allow us to examine our industry, and we will certainly be able to help the market to respond by leading it into a world of best practice.

AB: What role could or should ACI play around the whole fixing scandal?

MB: I think if you are a head of compliance or legal, or a senior executive or on the board of a financial institution and you need to satisfy yourself or your board or your shareholders that members of staff are completely *au fait* with best practices and model code behaviours and have a way of endorsing those behaviours through education, certification and ratification then you are going to be in much more comfortable position.

I believe that we are in a regulated business, but it is self-regulation, and joint cooperation around best behaviour is going to be most effective if it is done on a level playing field, i.e. if financial institutions and professional participants are subject to the same rules and behaviour and we use an internationally accepted code like the Model Code rather than splintering off regionally or using different measures for commercial purposes.

Our clients are global, our membership is global, we represent both the buy-side and sell-side, we represent people who trade and people who don't trade in the marketplace and the foreign exchange industry is the world's biggest market, so to be able to come to the ACI and provide that assistance with each segment in the trading community seems to me to be an obvious way to go.

AB: What challenges and opportunities do you see for the Association in the year ahead?

MB: The biggest opportunity for the membership is to become relevant to global financial markets. That opportunity, like so many things in so many industries, comes out of the challenges of the global financial crisis and the LIBOR and foreign exchange benchmark order execution questions. And because there are things to improve upon, like conduct with client information, I think there will be opportunities for us to offer members fresh reasons to join. Because our existing membership provides such personal commitment I'm sure when others join they will also want to participate in new ways, and we will find ourselves with all kinds of new momentum as a result of volunteering.

AB: So one of your aims is to increase membership?

MB: Absolutely. We have been increasing membership and broadening the types of asset classes that we represent. Foreign exchange is our core strength and we can legitimately claim to represent the foreign exchange industry as a result of the core expertise that comes from that but we should do as well in other asset classes as we have done in FX. We also have had stronger membership in some regions than in others. My view is that if you are a professional market participant and you want to participate in a group like ACI – The Financial Markets Association that has a history and a tradition of best practice, why would you not want to join us? It doesn't matter where you are in the global markets. And to your question earlier about whether we are going to lobby, there are plenty of associations and industry groups that are doing wonderful work and represent various segments of the market. From my perspective, if you want to join ACI, you're very welcome and if you want to participate and help us to get better you're very welcome to do your part as well.

AB: Do you plan to work with these other industry groups?

MB: Yes, I think there is a place at the table for all of us and what I want to ensure is that we understand what the others are doing and we play to our strengths and do what we do well. We are not specialist lobbyists in ACI, and do not represent one segment. We focus on conduct and education, and provide strong support to our members in other areas. To the extent that we may have gaps and other groups have strengths, we can help to fill in with our specialism by working together.

AB: What do you plan to discuss and achieve in Berlin?

MB: What I want to do is understand the views and concerns of the senior ACI leadership. What they say is really important to me and from all of this I hope to have an endorsed vision that I can work with and execute on the mandate given to me by these people. So I'm never going to have a better chance in my first month on the job to really sink my teeth into it as I have this week, I'm really excited about it.

AB: What message would you like to give to ACI members?

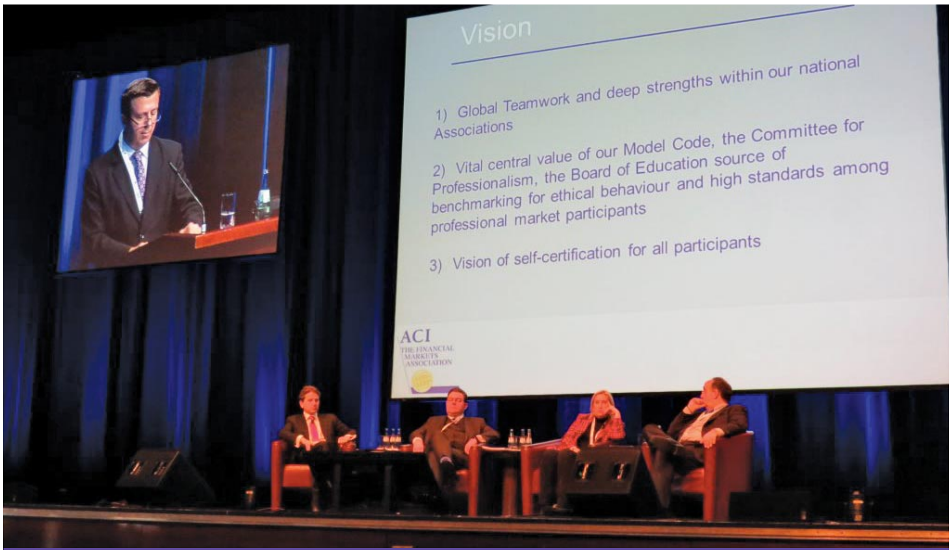
MB: To me the message is the importance of what we, as an Association driven by individual membership, can bring to an industry that is frankly crying out for leadership and knows that while it has always tried to do the right thing and is full of well educated, hardworking, determined, professional market participants, it has a chance now to do its job better.

As an example of that, over the last month activity in the foreign exchange market has dropped off dramatically, and participation in the fixes has dropped off dramatically, but why? To me the answer is obvious – the reason why people have pulled away from doing what they know how to do very well is that there is too much uncertainty about what can and can't be done. It's that uncertainty that we can help clarify. The market has been frozen by uncertainty. We will help to bring clarity through dialogue.

What we as an Association can do is help shine a light on what is expected as a professional market participant around this kind of activity and if I were a trader I would welcome that clarification; if I were the head of compliance or legal I would want to be reassured that people working for me understand best practices and from that, as has always been the case, people will do what is required to get things done and to do their jobs well. Individual bank codes of behaviour will not be as trusted, not as robust, and might add to the confusion. ACI's membership has helped drive a globally accepted Code. Members have always had their clients' interests at heart, they've always had their shareholders' interests at heart and we can help them along.

Meet the President

Marshall Bailey was officially inaugurated as the ACI-The Financial Markets Association's first full-time President in its 60-year history at the 53rd ACI World Congress.



MARSHALL BAILEY ADDRESSING ATTENDEES AT THE ACI GENERAL ASSEMBLY

Addressing attendees at the Congress in Berlin, Bailey, who has held a range of senior financial managerial roles over a 25-year career, said: "During much of this time I have been a proud member of ACI. I remember with fondness the honour we felt when saying that our 'word is our bond' and 'once a dealer, always a dealer', because that was the moral code that testified to the gold standard of our reputation as traders."

A former foreign exchange trader, London-based Bailey was chief operating officer, UK and EMEA with State Street Global Markets, managing the Markets business day-to-day until his departure in December 2012. During his time with State Street he also served as head of the London branch of State Street GmbH and held the roles of Director in State Street Bank Europe and Chairman of State Street Global Markets International.

He joined State Street following an 18-year career with RBC Capital Markets in Toronto and London, where he served as head of EMEA and Asia global financial institutions, global head of central bank coverage and as head of institutional FX. Prior to this he was an FX and fixed income trader at UBS in Geneva and Toronto.

"My appointment is the first ever full-time global President delegated by the Managing Board in the ACI Global Council. For all of us here this represents an opportunity to review our activity and to drive our Association in the direction we need," he said. "It is the power of your voices that are represented globally that will continue to see the strengths of our Association shine through."

His appointment comes at a critical time, particularly for the foreign exchange market which is facing one of the biggest crises in its history. While investigations into allegations that traders colluded to manipulate benchmark fixings of rates continue and financial markets face the spectre of increased regulation, Bailey believes the upheaval will ultimately improve the way markets operate. He also firmly believes that ACI has a role to play in providing clarity on what is allowed and what is off limits in the trading environment.

"The errors committed before the financial crisis set in and the exposure that is given to the darker side of banking culture means that all permitted market participants are facing increased regulation and demands that we prove ourselves to be of the highest quality," he told delegates in Berlin. "We at ACI are of the highest quality and we have a way of proving it."

He pointed to the Association's long held Model Code, a code of conduct written by practitioners for practitioners that covers standards of behaviour, including guidance on morals and ethics, personal conduct and dealing practices.

"When the global financial crisis put our industry under more pressure than it has seen in many lifetimes, and the public who spent their tax money bailing the system out demanded changes to what they see is a banking culture that has distorted values, the ACI Model Code has been a guiding light for the FX and other professional markets. It can be used by our membership to show that we, as ACI members, believe in having the right culture for our industry, a culture based on ethical behaviour, the highest standards of dealer and operations education and an inclusive and diverse group of individuals to find a practical answer to the practical problems that we face," he said.

"For our markets' behaviour to be less criticised we need to educate all sides including politicians, regulators and the media about how benchmarks are set, how fixings work, what is good, what is risk, and importantly how to avoid falling into bad habits with respect to sharing information inappropriately on clients' behaviour. We have very important things to say about this. I know that if I were the global head of compliance or the general counsel in the legal department or the head of markets, the head of trading or a junior dealer starting a career, I would demand proof that my area of responsibility was compliant with the Model Code.

"Our strength is that we provide guidance on ethics and behaviour in a largely self-regulated market via our offer of the Model Code," he continued. "It is critical because our membership organisations representing the buy-side as well as the sell-side in foreign exchange, money markets, fixed income, commodities, derivatives and many other professional areas are demanding clarification and guidance. We can educate and certify to provide safety and comfort for those wanting to follow best practice.

"We can use our experience, our history and our leadership from each of you," he told attendees, "to create a secure environment for ourselves and for the next generation of our membership and we can expand into new markets, we can rebuild the associations that have fallen away and we can work globally to secure a financially viable Association internationally, capable of meeting the needs of the 21st century."

Bailey said the ACI would follow on from the strengths and great work done by previous Presidents, particularly Manfred Wiebogen who led ACI for six years. Wiebogen was commemorated for his work, dedication and many achievements for ACI at the General Assembly at the Congress.

ACI Germany Hosts World Class Congress

The 53rd ACI World Congress, hosted by ACI Germany in Berlin from 27 to 29 March 2014, was heralded a great success by attendees, speakers and exhibitors alike.
Financial market professionals from all sides of the markets attended the Congress to participate in a business program that dealt with many of the crucial issues facing today's financial markets.

EDDIE TAN SPEAKING AT THE ACI GENERAL ASSEMBLY

As an industry we need to stay resilient and strong, we need to adapt to the [regulatory] changes and meet the challenges head on. ACI is no exception, we need to represent our membership and their interests

"ACI Germany is proud that more than 1,000 participants from all over the world followed our invitation to attend the 53rd ACI World Congress in Berlin," said Georg-Heinrich Sieveking, President of ACI Germany. "We are very happy that we could offer to so many delegates our comprehensive program on the most recent questions and trends across the financial markets business, as well as opportunities for discussions and networking among business partners."
Following a dinner exhibition to welcome attendees, the two-day business program began on 28 March with the ACI International General Assembly. Eddie Tan, Chair of ACI began his speech by outlining the challenges the financial markets face and how the industry needs to be resilient and strong.
"We, the ACI, must take the same lesson as Berliners, who are strong and resilient people, for the banking and financial markets are going through a difficult period of time and the toughest challenges are still ahead of us," he said.
"There have been many changes for the industry and the banking sector at large and we are all going through some form of structural transformation to win back the credibility with our regulators and customers. The regulator landscape has changed rapidly and is forcing banks to rethink and react to the demand of stringent rules," Tan said.
"While regulations such as Dodd-Frank and EMIR have their merits, the reality is that the heightened regulatory environment has brought its own problems. These regulations have unintentionally shifted much of the recent activities into the less regulated shadow banking sector. This is creating a concentration of risk and is real in Europe, in the US and all of the emerging markets.
"Banks are also struggling to find growth. Where is profitability going to come from? Many US and European banks are struggling to lower their cost income ration. Regulatory capital is going up, therefore cost is going up," Tan said. "In addition, business models are being challenged by this environment which is seeking transparency over costs and stringent protection through substantial holding of capital. Banks today are often seen as a utility-like model with nominal returns.
"This is not an encouraging position. As an industry we need to stay resilient and strong, we need to adapt to the changes and meet the challenges head on. ACI is no exception. We need to represent our membership and their interests in all these arenas. We can only do that by promoting skill development in our professions and promote the quality of our engagement with all players in the market space.
"ACI is moving forward and embracing this change. It has a full time staff and President, and the Board Committees are working hard in the areas of training, accreditation and engagement with the financial markets. ACI can stay strong and resilient, it must stay relevant, and we will become a stronger organisation."
Tan then handed the assembly over to the Chairs of the Committee for Professionalism (CFP), the ACI FX Committee (ACI FXC) and the Board of Education to discuss the projects that they are working on.
David Woolcock, Chair of the CFP, said the Committee plans to amend or include a number of sections this year to ACI's guidelines covering the professional activities of financial professionals – the Model Code – in response to market demand. He highlighted four particular areas of focus: expanding the advice on what the Committee regards as best practice concerning rate settings; adding best practice guidelines for foreign exchange aggregation procedures; providing guidance for trades that are done at technically off market rates, often referred to as mis-hits or off-market trades; and monitoring the volumes in virtual currencies, particularly the Wocu and Ven. If these reach an efficient volume and form a significant part of the market then the CFP will consider adding best practice guidelines to the area of virtual currencies.
Stephane Malrait, Chair of the ACIFXC, gave attendees an update on US and European regulation, the differences and how

continued on p.5 ▷

Congress Continued from p.4

regulation has and will impact the FX market in the year ahead.

"The definition of an FX forward is an issue in Europe because it is considered by the European Commission as a derivative but its implementation of that for each local jurisdiction in Europe is different," Malrait said. "For example in the UK for the moment it is not considered a derivative where it is in some other European counties. For that the European Commission is working on a clarification in order to have a unified mandate. This is still work in progress."

EDDIE TAN AND MANFRED WIEBOGEN

He added, "MiFID is going to be the trading requirement to trade electronically. It has been defined at the European regulation side and now it is in the process of being written into law by ESMA for derivatives. This will happen this year so it is important for the ACI FXC to focus on this and see how we can help the industry."

Malrait also discussed the findings of a White Paper, co-produced by the ACI FXC and financial market consultant Adsatis, on the impact of regulation to the buy side, highlighting concerns regarding the imposition of trade reporting, central clearing and transacting on approved electronic venues.

Updating attendees on the work of the Board of Education, Claudia Segre, Chair of the BoE, said it has updated the ACI Dealing Certificate with a new ALM topic and a revamped risk topic and has updated and extended the ACI Operations Certificate with a new topic, Best Practices Operations. In addition, the Board of Education has created a new ACI Model Code Certificate and a new Senior Certification. The Model Code exam will at the same time be a pre-requisite for participants to become eligible for the ACI Diploma for ACI Operations.

> *The feedback we get from a lot of the buyside is that there is still a need for a reference price*
> *Stephane Malrait*

In other developments, the new ACI Global Education Centre online platform (WikiACI) has become increasingly popular and provides candidates with two study guides, one for the Dealing exam and one for Operations exam.

In another important development, the Board of Education is launching a new ACI Diploma, the first four units of which are scheduled to go live in October.

After the Committee updates Tan called Marshall Bailey, the newly appointed full-time President of ACI, to the stage to address the audience.

During the General Assembly Manfred Wiebogen, the former ACI President and Honorary ACI President gave a farewell address to the audience. Tan thanked Wiebogen for his dedication, tireless work and numerous achievements over his six-year term and attendees applauded and gave him a standing ovation.

The General Assembly was followed by a high level buy side/sell side panel discussion on recent developments in the foreign exchange markets with a particular focus on fixings, regulation and how to keep the ethos of a self-regulated market alive.

The panel discussion was moderated by Woolcock and the panellists included: Malrait; Chris Knight, head of e-trading (East), FX, rates and credit, Standard Chartered; Robert Entenman, Global Head of e-Commerce, UniCredit Banking Group; Paul Chappell, founder and CIO of currency manager, C-View; Patrick Fleur, manager of trading and execution at PGGM Investments; and Sven Carlsson, head of markets at Ericsson Treasury.

With regard to the ongoing fixing enquiries, the panellists agreed that while there is a need, particularly internally, for a benchmark fixing rate, using algorithms could be a better way of getting currency trades done.

All panellists are members of the ACI FXC, which recently released a white paper gauging the buy side's reaction to upcoming regulatory changes in the FX market. Stephane Malrait, Chair of ACIFXC told attendees: "The feedback we

continued on p.6 ▷

JENS WEIDMANN

HELMUT RITTGEN

Congress Continued from p.5

get from a lot of the buy side is that there is still a need for a reference price. The FX market doesn't have an opening or a closing price so we need a way to be able to permission a reference price."

He continued, "However, we are seeing more and more investors using algorithmic trading to smooth their trading requirements. The fix was created for a purpose but if you have 200 million of a currency that you wish to sell and you try to do it at 4pm in one minute and it's an illiquid currency, of course you are going to move the market. Therefore it is much better to slice and dice and execute an order over time using an algorithm."

The panellists also discussed regulatory fragmentation and the possibility of regulatory arbitrage and the buy side relationship with banks.

Contact sessions closed out the day's proceedings before delegates enjoyed the evening party, with the theme of "Germany meets the World" at the U3-Subway tunnel.

The next day began with the General Assembly of ACI Germany. In parallel Helmut Rittgen, Head of Cash Policy Department Deutsche Bundesbank gave a keynote speech to international delegates on the introduction of the Deutsche Mark in the former German Democratic Republic. Following this, a speech was made to all delegates by Jens Weidmann, President of the Deutsche Bundesbank, on the economic and monetary situation in the Eurozone.

The morning sessions closed with a keynote from Peter Zöllner, Head of the Banking Department at the Bank for International Settlements on recent trends in the foreign exchange and money markets.

Total FX turnover reached an all-time high of $5.3 trillion per day in April 2013, up by 35% relative to 2010, Zöllner said. He attributed a large proportion of this growth to a rise in participation by non-dealer financial institutions. The volume share of non-dealer counterparties rose from $1.9 trillion per day in 2010 to $2.8 trillion per day last year, an increase of 48%, and accounted for around two thirds of the rise in total turnover during those three years.

> *The inter-dealer share of turnover has fallen from 63% in the late 90s to 39% in 2013*
> *Peter Zöllner*

Zöllner also commented on the fall in the inter-dealer share of turnover from 63% in the late 1990s to 39% in 2013, saying that the fall came about for two reasons: banks netting more trades internally, and the emergence of more sophisticated electronic dealing technology, incorporating liquidity aggregation and algorithmic trading.

He also discussed the currency composition of the turnover in 2013 pointing out two major themes that stood out last year: a 60% increase in yen turnover relative to 2010, and a significant rise in the global importance of emerging market currencies. The share of key emerging market currencies in total turnover increased from 12% in 2007 to 17% in 2013, he said.

In the afternoon, the World Congress played host to a stream of workshops covering recent trends in Asset Liability Management, Covered Bonds, Credits, Foreign Exchange, Liquidity Management, Regulation and Repos. Topics ranged from regulatory issues to ESM and EFSF, Paper or Gold and central counterparty clearing.

The Congress closed with a final networking event in the evening, the Gala Diner, which included the traditional handing over of the ACI flag to ACI Italy, the next host of the World Congress. The 54th ACI World Congress will take place in Milan from 12-15 February 2015.

ACI Germany would like to express its special thanks to the exhibitors and sponsors for their support of the Congress. In a highly frequented exhibition area, delegates had the opportunity to see many of the latest products and innovations available in the market.

ROBERT ENTENMAN

The Benefits of Algos vs Fixes: Panel Discussion

While there is a need, particularly internally, for a benchmark fixing rate, using algorithms could be a better way of getting currency trades done, said a panel of buy- and sell-side speakers at the ACI World Congress.

PANELLISTS: CURRENT DEVELOPMENTS IN FX – A SELLSIDE-BUYSIDE DISCUSSION

Instead of pushing large trades through so-called fixes, one of the most popular being the WM/Reuters 4pm closing spot rates service, investors could benefit from using algorithmic execution, typically a method to execute larger tickets into the market without the order being discovered.

"It is impractical to try and put a vast transaction through a fix that exists for a nano-second in time," said Paul Chappell, founder and CIO of currency manager, C-View. "There are now an increasing number of facilities available for investors to slice and dice interest through timing execution around fixing times. I believe it would be more prudent for industry participants to move towards using some of these automated processes in order to smooth the flow and impact of any large projected transactions."

Chris Knight, head of e-trading (East), FX, rates and credit, Standard Chartered, agreed with this sentiment. "Technology could definitely help investors achieve better execution. For instance, client algorithms, slice and dice etc. There are successful dark pools in the market now that could also potentially be used – firms could put in an interest and see if they can offset it. I can see different mechanisms becoming available for investors," he said.

The benchmark fixes were introduced 20 years ago for asset managers, investors and corporations to provide them with a standard set of currency rates so that portfolio valuations could be compared with each other and their performance measured against benchmarks without having any differences caused by exchange rates.

The benchmark rates are determined on the basis of buy and sell transactions conducted by FX traders during a 60-second window (30 seconds either side of 4pm).

The benchmark rates for 21 major currencies are based on the median level of all trades that go through in this one-minute period. The benchmark rates are used to value trillions of dollars in investments held by buy-side firms globally.

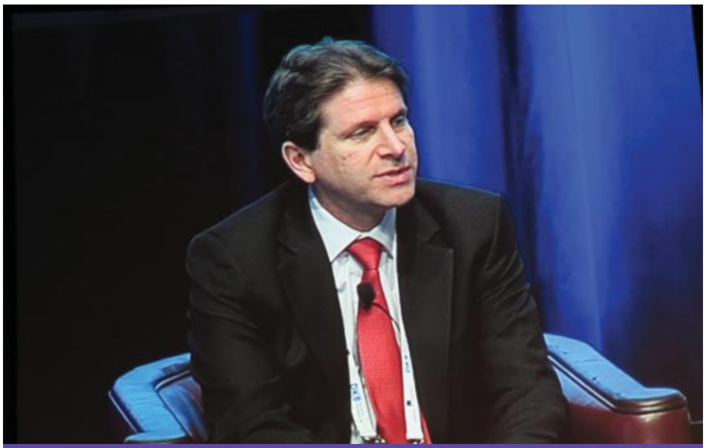
Stephane Malrait, Chair of ACI's FX Committee, which recently released a white paper gauging the buy side's reaction to upcoming regulatory changes in the FX market, told attendees at the Berlin conference: "The feedback we get from a lot of the buy side is that there is still a need for a reference price. The FX market doesn't have an opening or a closing price so we need a way to be able to permission a reference price. A lot of corporate clients and asset managers have to trade with their different Treasury centres at a reference price; therefore they need to have this for accounting reasons and for booking an internal trade."

He continued, "However, we are seeing more and more investors using algorithmic trading to smooth their trading requirements. The fix was created for a purpose but if you have 200 million of a currency that you wish to sell and

continued on p.8 ▷


PAUL CHAPPELL


CHRIS KNIGHT



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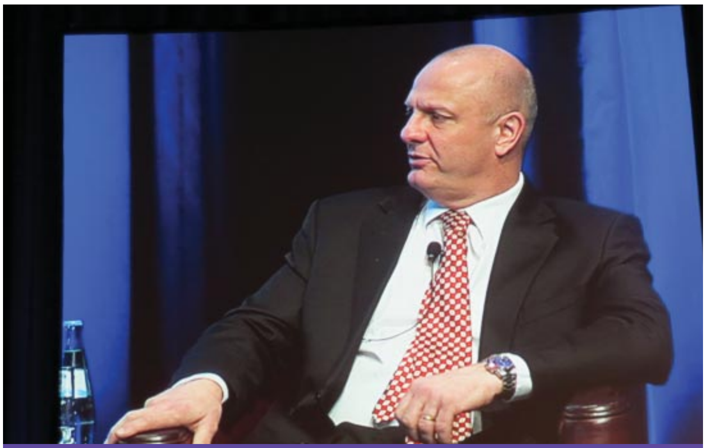


SVEN CARLSSON

Algos vs Fixes Continued from p.7

you try to do it at 4pm in one minute and it's an illiquid currency, of course you are going to move the market. Therefore it is much better to slice and dice and execute an order over time using an algorithm and then have a tool to measure the efficiency of your algo. But algo execution is still in an early stage in FX compared to the equities market. It's definitely growing but still a small part of the market."

Reiterating Malrait's point, Sven Carlsson, head of markets at Ericsson Treasury, added: "We don't use fixing when we execute externally, however we do use it internally. Our accountants want to have a reference rate. We have a defined and limited risk mandate to execute and we have good executers who trade when it's appropriate, when there's a market for it. We execute over time rather than at one point to smoothen the market impact and secure the best possible price. However, internally it's important for us to be able to show transparency on the pricing by the fix to secure confidence from our internal clients."

Patrick Fleur, manager of trading and execution at PGGM Investments, agreed. He told attendees: "I do think there is a need for fixings, now and in the future. We see trends that people want to invest in beta, which are investable and transparent and therefore accountable, so there is a need from our clientele for transparent products.

"However, we do recognise that the fix is not always a good reflection of the average price of the day, therefore we transact with a lot of algos."

PGGM uses close to 100 algorithms to transact currencies throughout the day, Fleur said.

The panellists' comments were made in the wake of allegations that senior traders at banks used electronic chat rooms to share client order information and then "colluded" to move markets away from client orders ahead of the WM/Reuters fix. The allegations have led to the suspension of more than 30 members of the foreign exchange markets and formal investigations have been started by several regional regulatory bodies.

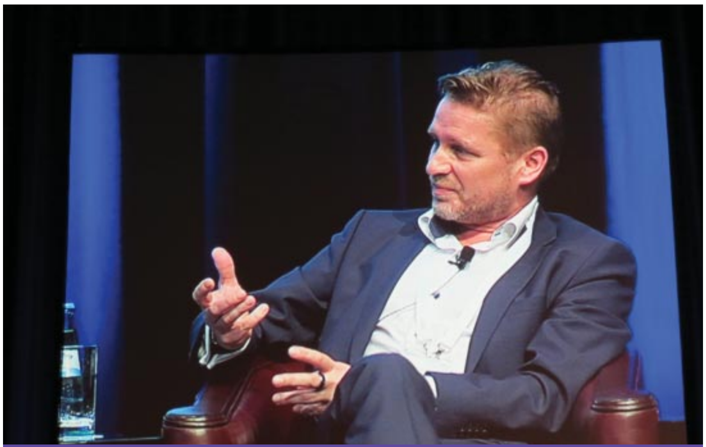
While the headlines have involved the words "collusion" and "manipulation" there is a strong body of opinion throughout the FX industry that if proved, the allegations are actually those of "front running" customer orders rather than a deliberate attempt to move markets, meaning that the profits the traders earned through their actions ultimately came directly out of investors' pockets.

ACI believes its Model Code of conduct for traders – already used by many major institutions – can play a central role in the industry's efforts to take action of its own before regulators sink their teeth in to the issue.

David Woolcock, Chair of the Committee for Professionalism (CFP) and Moderator of the panel discussion, said, "The Model Code covers client confidentiality and the fiduciary duty that people have towards that. It has definitions of front running, parallel running of orders and it covers the tricky areas of collusion and market manipulation. It also puts a line in the sand as to what is a sensible risk mitigation tactic and what would constitute insider trading."

He added that while its content is relevant and correct the CFP will consider expanding the advice on what it regards as best practice concerning rate settings.

"I think we will see an evolution of best practice recommendations and the Committee for Professionalism and the ACI FX Committee are working very closely on how they might be formulated," Woolcock said.



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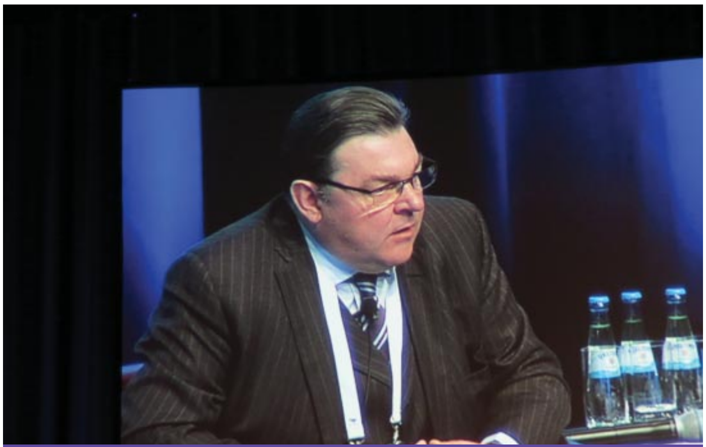

DAVID WOOLCOCK

Non-Dealer Financial Institutions Behind FX Volume Surge

Greater participation in the foreign exchange market by non-dealer financial institutions was a major factor behind the surge in FX volumes in the three years to 2013, said Peter Zöllner, Head of the BIS Banking Department, in a presentation to attendees at the 53rd ACI Financial Markets World Congress.

The volume share of non-dealer financial counterparties rose from $1.9 trillion per day in 2010 to $2.8 trillion per day last year, an increase of 48%, and accounted for around two thirds of the rise in total turnover during those three years. Total FX turnover reached an all-time high of $5.3 trillion per day in April 2013, up by 35% relative to 2010, faster than the 20% rise from 2007 to 2010.

Zöllner's comments drew mainly on the Bank for International Settlements' 2013 Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity.

He said greater participation by non-dealer financial institutions represented a sea-change in the make-up of participants in the FX markets, which had traditionally been dominated by inter-dealer trading.

To illustrate the point, Zöllner said the inter-dealer share of turnover fell to 39% in 2013, much lower than the 63% in the late 1990s.

For the first time in its 25-year history, the Triennial survey provided a more granular breakdown of non-dealer financial institutions in 2013. Zöllner said the increase in FX turnover was driven mainly by two categories: lower tier banks; and institutional investors and hedge funds.

A significant proportion of dealers' transactions with non-dealer financial customers in 2013 was with lower-tier banks. While 'non-reporting banks' tended to trade smaller amounts, and sometimes traded these sporadically, in aggregate they accounted for roughly one quarter of global FX volumes.

The other significant category was professional asset management firms, captured under the two labels 'institutional investors', including mutual funds, pension funds and insurance companies; and 'hedge funds'. The two groups each accounted for about 11% of turnover.

Commenting on the fall in the inter-dealer share of turnover, Zöllner said: "This is the flip side of the increasing importance of 'other financial institutions', and has come about for two reasons. The first is that major dealing banks nowadays net more trades internally. Due to higher industry concentration, top-tier dealers are able to match more customer trades directly on their own books, which reduces their need to offload inventory imbalances and hedge risk via the traditional inter-dealer market."

The second, he said, is the emergence of more sophisticated electronic dealing technology, incorporating liquidity aggregation and algorithmic trading, and which is also now accessible to a much broader range of market participants.

Similarly, non-financial customers, mostly comprising corporations, but also governments and high net worth individuals, accounted for only 9% of total FX turnover, the lowest level since the inception of the Triennial in 1989.

Reasons for the shrinkage in this category included the sluggish recovery from the global financial crisis, low cross-border merger and acquisition activity and reduced hedging needs, as major currency pairs mostly traded in a narrow range over the past three years. Another key factor was more sophisticated management of FX exposures by multinational companies.

"Firms are increasingly centralising their corporate treasury function, which allows hedging costs to be reduced by netting positions internally," Zöllner said.

Emergence of algorithmic trading

The emergence of liquidity aggregation and algorithmic trading techniques has increased interconnectivity between a greater number of market players and enabled a more widespread sharing of risk among market participants, while also enabling quicker execution times and lower trading costs. This also contributed to a rise in total FX turnover.

"The more fragmented structure that emerged after the demise of the inter-dealer market as the main pool of liquidity could potentially have harmed trading efficiency by raising search costs and exacerbating adverse selection problems. Yet, one of the most significant innovations to prevent this has been the proliferation of liquidity aggregation. This new form of aggregation effectively links various liquidity pools via algorithms that direct orders to a preferred venue e.g. the one with the lowest trading costs," Zöllner said.

"Widespread use of algorithmic techniques and order execution strategies allows the sharing of risk to occur faster and among more market participants throughout the network of connected venues and counterparties. Over the period 2007 to 2013, algorithmic trading at EBS grew from 28% to 68% of volumes."

The availability of new dealing technologies has redefined the roles of each of the major FX market players. Electronic trading in general and retail-oriented trading platforms in particular have provided FX market access to a broader range of end users and favour a more active participation of non-dealer financials, he said.

Zöllner also discussed the currency

continued on p.10 ▷

The fragmented structure that emerged after the demise of the inter-dealer market as the main pool of liquidity could potentially have harmed trading efficiency...One of the most significant innovations to prevent this has been the proliferation of liquidity aggregation

FX Volume Surge Continued from p.9

composition of the turnover in 2013. The US dollar retained its dominant position with an 87% share, rising from 84.9% in 2010, while the share of the euro decreased from 39% in 2010 to 33% in 2013. Two major themes stood out last year, he said. The first was a 60% increase in yen turnover relative to 2010, lifting its market share to 23%. The monetary policy regime shift by the Bank of Japan triggered a phase of exceptionally high turnover, peaking in April 2013. However, yen trading had already started to rise rapidly in late 2012, as market participants anticipated Abenomics.

The second theme was the significant rise in the global importance of emerging market currencies. The share of key emerging market currencies in total turnover increased from 12% in 2007 to 17% in 2013.

"As liquidity in emerging market currencies has improved, these markets have attracted the attention of international investors. The strong growth is particularly visible in the case of the Mexican peso, whose market share now exceeds that of several well established advanced economy currencies. Another important case is the renminbi, which has experienced growth of 250%, mainly due to a surge in offshore trading. China set itself the task of promoting more international use of its currency and introduced offshore renminbi (CNH) in 2010."

While trading in renminbi represented only 2% of global currency trading last year, international use of the renminbi has been increasing, with about 17% of China's global trade settling in its own currency last year compared with less than 1% in 2009.

Anther factor accounting for the rise in FX turnover was a growth of investment in international assets. With yields in advanced economies at record lows, investors increasingly diversified into riskier assets such as international equities and local currency emerging market bonds. Over the past three years, equities have provided investors with attractive returns, emerging market bond spreads have simultaneously dropped, and issuance in riskier bond market segments – for example local currency emerging market bonds – has soared.

"Not only did these three factors give rise to the need to trade FX in large quantities and to rebalance portfolios more frequently, but it also went hand in hand with greater demand for hedging currency exposures. This triggered currency trading as a by-product of investments," Zöllner said.

Trends in Money Markets

Turning to recent developments in money markets, Zöllner said there have been two noticeable trends over the past quarter: an increase in secured funding and changes in the repo market.

"There has been an ongoing sizeable shift from unsecured to secured funding by financial institutions, particularly in the euro area, as well as a shortening of maturity. In the unsecured market, banks' cash borrowings decreased by 44%, while their lending declined by 17%, with trading activity remaining concentrated on maturities of less than one week."

Overnight transactions account for the majority of borrowing and lending activity in the unsecured market. The secured funding market's total turnover rose by 17%. This was driven mainly by a 27% increase in overnight maturities, while the turnover out to one week increased by 16%.

The ICMA European repo market survey estimated that the market shrank by 8.2% over the second half of 2013 compared to growth of 8.6% in the first half. Despite the slightly positive year-on-year growth, the total market size remains below the levels observed in 2011 and before the crisis. Anticipation of future regulatory constraints is one reason for the continued contraction in repo books, Zöllner said.

The composition of the repo market has also been shifting. As market confidence continues to recover, the share of directly negotiated repos has increased at the expense of electronically traded repos.

"Furthermore, the share of anonymous electronic trading cleared through central counterparties has increased, contrary to anecdotal evidence suggesting that banks were opportunistic in looking for lower haircuts in the uncleared market."

One potential reason for this, Zöllner said, was the increasing tendency of Italian banks to trade through CCPs as a result of heightened counterparty credit concerns.

"In terms of collateral composition, there has been a notable increase in Italian collateral, and to a lesser extent Spanish collateral, while the share of German collateral was unchanged. However, the triparty agents noted that the biggest increase has been in French collateral, reflecting increased collateralised lending by US money market mutual funds to French banks."

As banks continue to repay the liquidity facilities provided by the ECB, they have returned to the repo market for funding. The survey reveals that the market share of euro-denominated repos has recovered from 57% in June 2012 to 66% in December last year. As a result, collateral remains in high demand, not only from central bank holdings, due to asset purchases and capital requirements, but also from banks attempting to secure funding.

Zöllner concluded his presentation with some general observations about regulation. "The financial crisis exposed significant weaknesses in the resiliency of banks and other financial market participants to financial and economic shocks. As part of the response, the new Basel rules impose both qualitative and quantitative changes to capital requirements, in addition to minimum liquidity buffers," he said.

"Furthermore, systemically important, or 'too big to fail', banks have been identified and will be made to adhere to even more stringent standards.

"It is inevitable that compliance with all these regulatory requirements will involve costs. But, even with capital holdings well above the minimum levels set in Basel III, the initial investments will reap benefits in the long term. For one, a more resilient financial system will allow the global economy to grow with fewer interruptions from financial crises. And also, when crises do occur, they are likely to be less severe than before."

As liquidity in emerging markets' currencies has improved, these markets have attracted the attention of international investors...this is particularly visible in the Mexican peso, whose market share now exceeds that of several other well established, advanced economy currencies

Regulatory Focus: ACI FXC to Tackle Impact on Industry

The implementation of regulations in the global foreign exchange and derivatives markets will be a defining feature of 2014. As such, the ACI's FX Committee (ACI FXC) will continue to work with market participants, national ACI Associations and regulators to address the significant challenges these regulatory changes will bring.

Already this year, the ACI FXC has surveyed a wide selection of buy-side firms and produced a white paper highlighting their concerns on the imposition of trade reporting rules in Europe and incoming regulations concerning central clearing and transacting on approved electronic venues.

The White Paper was distributed to ACI members at the World Congress and to the media at large and is available on the ACI website. It is now being used by the ACI FXC as a valuable communication tool with regulators to raise awareness of those concerns and the potential impact these regulations will have on buy-side firms (see related story).

In the coming year, the ACI FXC will also look at the continuing FX fixing issue and will work closely with the Committee for Professionalism on making amendments to the Model Code to expand the advice it already provides on best practices in the area of rate setting. It will also continue to promote the Model Code to regulators and central banks.

"Generally there is a fear in the trading community because we are a self-regulated market and not everyone is aware of what is off limits. Potentially what was acceptable ten years ago might not be permissible now, so we will promote the use of the Model Code and push regulators and central banks to recognise it internationally. The Banque de France, for example, promotes it and uses it internally," said Stephane Malrait, Chair of the ACI FXC.

"At the World Congress at least three central banks came to us to discuss the Model Code and how it is implemented. Obtaining validation for it, not only from central banks and regulators, but from banks and buy side firms as well, will be a key area of focus for us," said Malrait.

"Promoting the Model Code to central bankers and regulators may result in us having to tweak it to support local requirements but this is more a medium to long term goal."

He continued, "In the short term what we want to do is go back to the idea of what is right, what is wrong. We would like to produce a report on current practices in the markets through surveying ACI members on their internal policies and what they think is and isn't admissible behaviour." ACI FXC is looking to launch the survey within the next three months.

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STEPHANE MALRAIT

The Committee will also continue to follow regulation updates closely and is in constant discussions with other industry groups. "The idea is that we can circulate information about the activities of these other industry groups back to members of ACI. ACI FXC isn't a lobby group for the main reason that we represent individuals, not the company they work for, and as such we bring a different type of trust to central bankers and regulators," said Malrait.

The ACI FXC represents the whole FX industry and promotes an orderly, transparent, well-functioning market. It has 17 members from different sectors in the FX industry, including banks, corporates, asset managers, money funds and trading platform providers. The members are located in the major trading centres in Asia, Europe and North America.

ACI Mauritius Hosts Education Event

The Financial Markets Association of Mauritius in collaboration with ACI Global and Thomson Reuters hosted an educational and networking event at Flying Dodo in March 2014. Participants were members of ACI, economic operators.

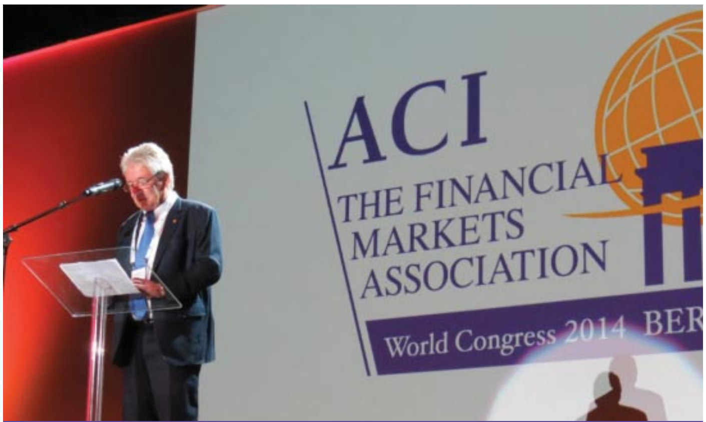
At the event, Brigid Taylor, ACI Regional Representative for Africa, stressed the importance of ACI. She also observed that ACI accreditation is one of the preferred requirements for financial markets in many countries and discussed the education programmes available, including the ACI Dealing Certificate, ACI Operations Certificate, and the ACI Diploma.

Taylor also addressed members of the fixed income markets in Mauritius and suggested a roll out of a programme to the market aimed at enhancing participants' understanding of how fixed income markets function, enable hands-on application to trading fixed income and deliver practical abilities in accessing pricing, to better enhance the secondary market flow of fixed income products in the local market.

The Congress in Pictures

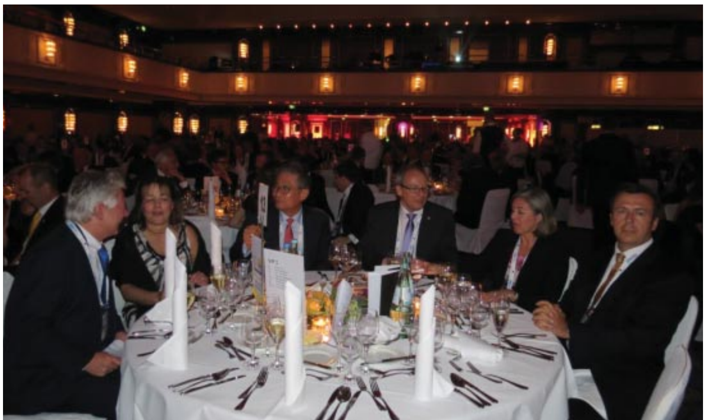

WELCOME EVENT - "GERMANY MEETS THE WORLD"

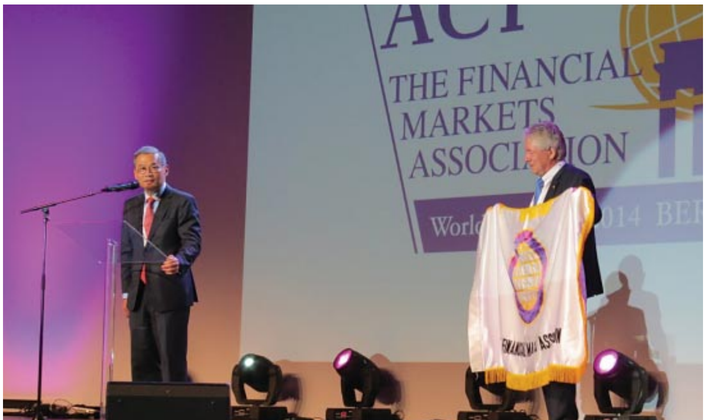

ACI GENERAL ASSEMBLY



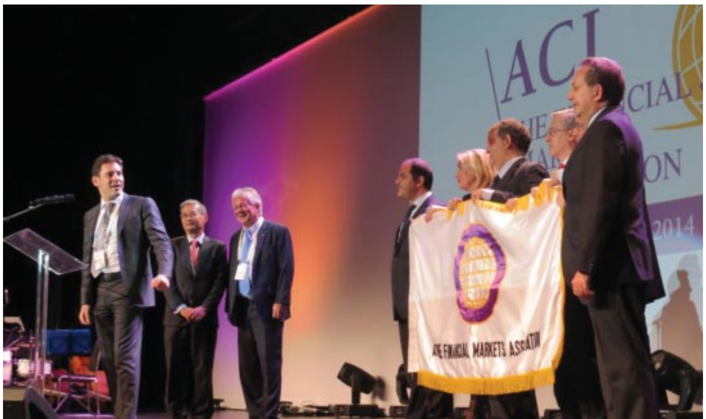
GEORG-HEINRICH SIEVEKING, PRESIDENT OF ACI GERMANY


GEORG-HEINRICH SIEVEKING AND PETER SCHUSTER


MEMBERS OF BERLIN ORGANISING COMMITTEE AND EXECUTIVE COMMITTEE


EDDIE TAN AT THE FLAG HAND-OVER CEREMONY

ACI WORLD CONGRESS 2015 ORGANISING COMMITTEE


ACI WORLD CONGRESS 2015 ORGANISING COMMITTEE

Committee for Professionalism to Add Sections to Model Code

The financial industry's need for the ACI Model Code has never been more pronounced than it is now and the ACI's Committee for Professionalism (CFP) plans to amend or include a number of sections to the Model Code this year in response to market demand.

Redrafted by the CFP in 2012 and 2013, the Model Code is a set of guidelines covering the professional activities of ACI members. It includes morals and ethics, personal conduct, dealing practices and segregation of duties, among many other areas in the front, middle and back office, and these form the main body of the code. Areas that are likely to change over time as the markets evolve are included in the Model Code as appendices.

"We are getting an unprecedented number of enquiries on the Model Code from banks and regulators who are seeking more information on what it contains, how we maintain it and how it is a global instrument written by practitioners for practitioners," says David Woolcock, Chair of the Committee for Professionalism, which advises the ACI Executive Board on market practices.

According to Woolcock and Keith Sedergreen, the recently appointed Vice Chair of the CFP, an area that has drawn a number of enquiries is related to the ongoing issue of fixing. They say market participants in different jurisdictions have asked the Committee to review the parts of the Model Code that concern rate settings.

"We believe that the content we currently have is relevant and correct but some people have approached us to see if we would expand the advice on what we regard as best practice concerning rate settings. The CFP is going to review that to see whether we can be more detailed in the best practices we recommend," says Woolcock.

The requests come against a backdrop of global regulatory investigations into allegations that traders at some major banks "manipulated" or "colluded" to move markets away from client orders ahead of the popular WM/Reuters 4PM Fix.

The allegations have led to the suspension of at least 30 traders with an increasing number of regional regulatory bodies announcing that they too have begun reviews to ascertain whether any wrongdoing may have occurred in their jurisdictions.

The CFP has maintained an active stance on the alleged rate rigging issue, firstly by issuing a press release the day after the first revelations, drawing the market's attention to the relevant sections of the Model Code in which the guidelines explicitly cover the responsibilities dealers have with regard to client confidentiality.

"This press release was well received and a lot of work so far this year continues to be giving background briefings about the Model Code to journalists and regulators," says Woolcock. "The Model Code covers client confidentiality and the fiduciary duty that people have towards that. It has definitions of front running, parallel running of orders and it covers the tricky areas of collusion and market manipulation. It also puts a line in the sand as to what is a sensible risk mitigation tactic and what would constitute insider trading."

DAVID WOOLCOCK

We are getting an unprecedented number of enquiries on the Model Code from banks and regulators who are seeking more information on what it contains, how we maintain it and how it is a global instrument written by practitioners for practitioners

The CFP is looking to add to the wording, so it is more fixing specific, adds Sedergreen. Included in the guidelines is a warning that dealers and sales staff should not "profit or seek to profit from confidential information" and that where a jurisdiction does not explicitly cover insider trading and market abuse in legislation or regulations, management should provide clear guidelines to staff on how to handle such information.

The Committee continues to recommend that banks using the ACI Model Code should have it signed by traders as read and understood and that they agree to abide by the letter and spirit of it, which is of course mandatory for all individual members of the ACI already.

In addition, the ACI's Board of Education has launched a module in their examinations on the Model Code. "This is a great addition for banks that are using the Model Code worldwide, as they can rest assured that not only have they asked their traders to read the Model Code, they can now test them on it," says Woolcock.

Aggregation

Another area for review concerns aggregation. Sedergreen says the CFP has been approached by a number of market participants who are trying to collaborate with the industry in an initiative to have some best practice guidelines around the use of aggregation.

"There is a mood in the market where people feel there should be precise best practice guidelines regarding aggregation. We have worked with a number of parties that are interested in this. We've spoken to vendors who supply aggregators and the banks who use them and the CFP will continue to consult with these participants."

The Committee will take on an intern this summer to examine and research the area of price aggregation and aims to add a section on best practices and procedures for FX aggregation – for example, how long a price should be displayed – to the Model Code in Q4 this year.

In a further area for review, the CFP has been contacted by parties regarding guidance for trades that are done at technically off market rates, often referred to as mis-hits or off-market trades, including what constitutes a mis-hit and a resolution process within that.

"Although we have a prolonged period of lower volatility in markets, and potentially because of a reduction in

continued on p.14 ▷

CFP Continued from p.13

liquidity, we are experiencing some extreme volatility in very short time frames," Woolcock explains.

While the Model Code provides guidance regarding these trades, the CFP has received requests for more detailed and updated market guidelines explaining whose responsibility it is to resolve any issues.

Participants have also asked the Committee whether it could come up with a new recommendation of best practice to provide firm guidance on when to amend or even if it is right to cancel trades.

"We have coverage in the Model Code of off-market trades but practices do evolve and best practice needs to follow that evolution. We have spoken to prime brokers, banks, platforms and all of them say they would welcome a better definition of what their responsibilities are when we have off-market trades occurring," says Woolcock. The CFP plans to unveil guidelines on off-market trades in Q4.

Virtual currencies have also made it onto the Committee's agenda this year with the CFP monitoring the use of the World Currency Unit (Wocu) and more recently the Ven, noting that it has anecdotal evidence that some oil companies and major multi-national companies are using the currencies for genuine risk mitigation.

KEITH SEDERGREEN

There is a mood in the market where people feel there should be precise best practice guidelines regarding aggregation

"We will continue to monitor the volumes that are traded in these currencies and if they reach a sufficient volume and form a significant part of the market then we will consider adding best practices in this area. The Committee has also looked at Bitcoin, but my personal view is that it is a fad and not really an area that we will be focusing on," says Woolcock.

"We're looking at these, but it's like any currency – we don't target specific currencies, rather we provide guidance on the procedures of trading currencies," says Sedergreen.

Expanding the CFP Team

In other news, the CFP has been adding to its team over the past six months and is in the process of recruiting some new members with particular expertise.

In October last year Sedergreen, who is a Managing Director at Tullett Prebon Australia, was appointed Vice Chair of the CFP. The newly created role ensures that ACI members have a contactable representative in the Asia region. In addition, Robert Entenman, Global Head of e-Commerce, UniCredit Banking Group, was appointed liaison between the CFP and the ACI FX Committee.

The CFP says it will be announcing a new member from the prime brokerage community shortly and hopes to expand the committee to 10 members this year.

Finally, in a move which serves to highlight the global reach of its work, the ACI Model Code has been translated into German following its translation into Chinese in 2013. The Committee is anticipating a translation into Italian amongst other languages later this year.

European Buy Side Expresses Concerns About FX Regulation Impact

The ACI FX Committee has released a White Paper that gauges the reaction of members of the buy side to upcoming regulatory changes to the foreign exchange market proposed under the European Market Infrastructure Regulation (EMIR), MiFID II and Basel III.

Produced in collaboration with financial market consultants Adsatis, the research highlights the buy side's concerns regarding the imposition of trade reporting, central clearing and transacting on approved electronic venues.

It finds that although corporates, pension funds and asset managers support the overall objectives of the regulations, many research participants believe the requirements have created confusion through a lack of agreed and timely definitions.

They also fear that FX markets – a relatively transparent market with little obvious systemic risk – and in particular vanilla FX forwards and swaps, which are primarily used for hedging by end-users, may be subjected to requirements originally devised to regulate the interest rate and credit derivatives markets post the financial market crisis of 2007-2008.

While they were found to be "generally resigned" to the impact of regulatory change on the market, many research participants felt that the inclusion of forwards and swaps in EMIR and MiFID II to be unnecessary and that it would bring few benefits in terms of transparency or reduction in systemic risk.

While the buyside was found to be "generally resigned" to the impact of regulatory change, many felt the inclusion of forwards and swaps in EMIR and MiFID to be unnecessary

Many companies were also found to be working under the assumption that FX swaps and forwards "for commercial purposes" would be exempt from most EMIR and MiFID II requirements.

Trade Reporting

Regulation concerning the implementation of trade reporting in Europe attracted the most feedback from research participants. According to Stephane Malrait, chair of the ACI FXC, many of the buy side participants interviewed were not ready or aware of their own obligations for trade reporting. Starting on 12 February 2014, EMIR

continued on p.15 ▷

Regulation Impact Continued from p.13

made it mandatory for European and multinational counterparties to report details of any derivative contract (OTC or exchange traded) that they had concluded, modified or terminated to an EU-recognised trade repository.

The implementation of trade reporting has already highlighted a problem, the research finds, of interpretation on what actually constitutes a derivative for the purposes of the regulation.

EMIR passed the definitional question onto MiFID II but as a directive, MiFID II left it to the national regulators in the European Union member states to adopt the rules, and their interpretation of the MiFID II definitions have varied. This is a particularly critical aspect in the classification between spot and forwards in FX and the definition of "FX forwards for commercial purposes".

The European Securities and Markets Authority (ESMA) then requested in a letter to the European Commission, sent on 14 February 2014, outlining the need for further clarity "as a matter of urgency" on which FX instruments should be defined as derivatives for the purposes of trade reporting and that the EC clarifies these definitions and passes an act, or a similar measure, to create a standardised definition across all jurisdictions within the EU.

On the 10 April, the EC launched a public consultation into the definition of FX spot and forward contracts. The consultation document asks for the industry's views on "where the boundary lies between what is an FX financial instrument and what is not; specifically the definition of a spot FX instrument".

The lack of clarity has so far resulted in FX forwards being excluded completely from reporting requirements in the UK and Luxembourg, based on how the MiFID definitions were interpreted by the UK Financial Conduct Authority and the Commission de Surveillance du Secteur Financier.

Under the EMIR reporting requirements, the exemption is for FX forwards with a settlement date up to 7 days and FX forwards that are concluded for commercial purposes. But according to the EC, the majority of member states do not have a "definition of a forward or delineate a boundary for FX spots in their legislation."

"Some member states have determined cut off periods of up to seven days before classifying a spot contract as a forward, although the majority "adopt a two-day delineation and/or look at standard market practice", the EC says.

"In practice, though, the delivery and settlement of a spot transaction does not take place immediately, for technical reasons or as a result of market practice, and normally takes place a number of days thereafter," the EC adds. "It is therefore necessary to determine how long 'immediate' is and at what point a spot becomes a forward."

In the US, FX forwards and swaps were excluded under Dodd-Frank, leading some market participants to expect EU regulation to follow suit. The EC is inviting responses to its consultation document until 9 May 2014.

"Apart from the regulators' desire for consistent application across the EU, these definitions are obviously a critical determinant of which companies are impacted by the new regulatory requirements. For a company to determine whether its transactions are relevant for the regulation and whether they exceed thresholds for compliance, it obviously has to be provided with precise definitions. It is absolutely clear that this uncertainty and confusion has added to the burden on all market users," the white paper research says.

From the spring of 2013, it became clear that the US approach of only requiring one counterparty (usually the bank) to report a trade to a central repository was also not necessarily going to be followed in Europe. The nature of the regulatory process in Europe, involving all member states, is inevitably more complex and slower moving than in the US. Also, the bias in Europe towards principle-based, rather than rule-based, regulation allows more scope for ambiguity, according to the research.

That accepted, nearly all buy-side firms consulted said that the imposition of trade reporting was unnecessarily confusing and prolonged. It was pointed out that even for companies whose FX activities were likely to be below any threshold and therefore unlikely to have to report, there was a considerable management burden in following the debate and investigating contingency procedures. Traditionally, SMEs rely heavily on their banks as advisors with regard to regulatory obligations. However, without clear definitions from the regulators, the banks themselves were cautious about informing clients that there was no need for action on their part.

Another area of criticism was that although there was theoretically enough time to allow implementation, delays on important points of detail meant that there was insufficient time to put in place reliable processes and technology. For this to happen the European trade repositories had to be authorised and they in turn had to agree and define required formats for reporting. Until that point, it was difficult for reporting entities to make real progress on implementation projects. It was also impossible for banks and service companies that intended to offer third party reporting to be precise about their service offering, timing and cost.

Companies consulted for the research also highlighted other problems related to reporting, the first concerning Legal Entity Identifiers. Providers of LEIs were also relatively late to the game and it was not clear until late in the process whether LEIs were needed for all subsidiaries, given the European requirement for large groups to report intra-group trades.

The implementation of trade reporting has already highlighted a problem of interpretation on what actually constitutes a derivative for the purposes of regulation

In addition, although guidelines for Unique Trade Identifiers were provided, it was not clear in all cases which counterparty was responsible for generating the identifier. Most respondents said they were intending to use the UTI from the bank or platform they dealt with, which again created a problem for intra-group trades. It was unclear for some time whether identifiers generated from the group's treasury system would meet the requirements.

Another problem identified by research respondents related to trade matching. The EU requirement for both parties to report a trade means that it is quite possible that the two counterparties enter slightly different details and could also be submitting these through different trade repositories. However, the matching reports which highlight discrepancies on a field by field basis are not permitted to provide counterparty A with the data that counterparty B has entered (or vice-versa). This has resulted in an onerous reconciliation process, respondents said,

continued on p.16 ▷

Regulation Impact Continued from p.15

that is almost totally manual and, even where the differences might be immaterial, a market user cannot simply accept the counterparty's value for the data item.

While it is too early to examine the extent to which the reporting requirements will help achieve the overall objectives of the regulations – namely to make the derivatives markets more transparent – companies consulted for the research made a number of observations.

The first was that the European authorities had not adequately explained why they needed such a comprehensive collection of data from both sides of a trade and which aspects they were going to analyse to enable better management of systemic risks. It was generally assumed that data would be centralised and analysed to identify concentrations of risk that would then be subject to further forensic investigation.

However, many research participants pointed out that this had never been stated explicitly nor had any guidance been given on what the authorities might be looking for. Many believed that, if this had been made clear, it would have been easier to prioritise and resolve issues that arose during the implementation process. In particular, given that intra-group trades were nearly always zero sum and that it was the net position between the group treasury and external counterparties that mattered, several large companies observed that reporting intra-group activity was a burden without obvious benefit.

It was additionally observed that it was easier to get senior management support and budget for projects when the benefits of the commitment could be clearly articulated and explained.

"Given that most end-users were not regarded as systemically important, it would have made sense to work out many of the definitional and practical implementation issues of reporting by starting with a relatively few large organisations such as banks and repositories who would have had the resources and the expertise to resolve these issues and implement solutions for themselves and third parties," says the research.

"The remaining reporting entities could subsequently have been brought into the regime with a clearly defined set of requirements and solutions, giving them clear and informed options on how they could proceed.

"The Australian authorities are broadly adopting this approach and it would appear to have merits, with little or no effective weakening of transparency and control. Phasing implementation may bring benefits to the other components of the regulatory framework and the ACI would recommend this approach to be considered wherever possible."

Malrait adds, "The impact of trade reporting isn't going to be only in Europe but for all users who trade with a European entity. This has a potentially global impact for ACI members."

Mandatory Clearing

The majority of respondents expect most corporates' FX activity to be exempted from mandatory clearing. However, the combination of mandatory clearing and Basel III/CRD4 capital costs seemed to respondents to be designed to drive as much derivative activity as possible on to an exchange, leaving those required to use OTC with a choice of clearing and posting collateral and/or facing significant increase in costs, unless the activity could be proven to be exempt.

The ability to manage the provision of initial margin and collateral requirements is something that varied considerably between respondents. Among the financial institutions, hedge funds typically have these arrangements handled by their prime broker so see no material change, apart from potentially higher costs.

Pension funds and their asset managers mostly have ISDAs with CSAs in place, so can also generally handle the process but expressed concern about the percentage levels of initial margin that might be imposed.

However, those consulted indicated that much of their currency hedging was conducted on a rolling, shorter-term basis and the impact would be greater for interest rate derivatives than FX. Intuitively, financial institutions would be better equipped to handle hedging through exchange-traded derivatives but that may not always be the case and the risk of unhedged FX exposures might remain.

From the corporate treasury viewpoint, most of those consulted were relying on the "commercial purposes" and threshold exemptions to avoid a burdensome commitment. The precise definition that determines whether a derivative is for the reduction of risks from commercial activities is back with the European Commissioner.

However, most treasurers said they only used derivatives for hedging and were confident of an exemption. The larger companies that were consulted were mostly already comfortable with the clearing process, had ISDAs in place and either already posted collateral or understood the potential burden.

The responses varied considerably as to how mandatory clearing might change behaviour but, on balance, research participants were concerned that, without exemption, tying up working capital in collateral would directly impact their commercial operations. The companies interviewed were assuming that the threshold exemptions would apply and had made no real provision for handling clearing at this point.

Michael Birks, executive chairman of Adsatis, says, "Pensions have a temporary exemption until 2016, and the feeling among the pension funds was that was really just to give the industry time to develop exchange traded derivatives to use instead of OTC instruments. The capital requirements on ETDs were much more benign, so in the next few years they will have to extend their use of these instruments.

"Pension funds felt the higher costs of derivatives would inevitably impact their longer term net returns, unless the industry developed adequate liquid instruments for FX which could be used as a substitute without too much associated basis risk. Corporates were saying that they may end up not hedging a lot of their FX risk because of the cost. If they do that, there are real economy implications for them as they may end up with more P&L and balance sheet volatility as a result."

The impact of trade reporting isn't only going to be felt in Europe...it has a potentially global impact for ACI members

Transacting on Approved e-Venues

The requirement to move sufficiently liquid derivatives to specified trading venues did not worry most research participants. Several respondents argued that the FX market was sufficiently liquid, transparent and, at the shorter end, largely executed over platforms that would

continued on p.17 ▷

Regulation Impact Continued from p.16

qualify under the wider definitions of MiFID, in contrast to SEFs in the US. Some questioned whether there would be sufficient liquidity in the longer term swaps and forwards for them to be viable instruments on an exchange type model. However, the prevailing view was that the general trend towards platform trading of FX, already in place before the legislation, would continue and that the regulation would not make a significant difference. However, it is clear that many users believe that standardising FX to fit with an exchange model is neither necessary nor desirable. Although they may meet criteria for liquidity and transparency, FX forwards and swaps are core banking products supporting commercial transactions and the bespoke nature of each contract needs to be maintained for the majority of users.

The organised trading facility (OTF) definition may not require such standardisation but, in those circumstances, many users did not see the benefits that would be derived from the requirement to move these instruments on to a platform.

One observation from all the direct feedback that could potentially improve the process of future regulatory changes is for the relevant European authorities to adopt a more coordinated and clear communication strategy to keep all market participants and relevant trade associations adequately informed.

Malrait says such feedback from the buy side is important for ACI, European regulators and the FX industry. “This highlights buy side concerns and the need for more dialogue between FX market participants that the ACI represents and regulators,” he said.

“In the US, there were a lot of meetings in Washington between regulators, the banks and the buy side to negotiate the best ways to implement US regulations. Even though the US was strict, there were at least dialogue and recommendations,” Malrait says.

Adsatis and ACI consulted with around 20 organisations, large and small, in January and February 2014 to assess how the regulation directly impacted their FX activity and their business as well as asking for their views on the wider implications. The feedback was supplemented by independent research from Adsatis and members of the ACI FX Committee.

The ACI White Paper was circulated at the ACI World Congress in Berlin.

Malrait says it will be used as a valuable communication tool between regulators and each ACI association.

Industry Concerns Push European Commission into FX Definition Consultation

The European Commission (EC) has launched a public consultation into the definition of FX spot and forward contracts, some two months after the start of mandatory trade reporting revealed different interpretations of the requirements were adopted by various member states.

It follows the European Securities and Markets Authority's (ESMA) letter to the Commission outlining the need for further clarity “as a matter of urgency” on which FX instruments should be defined as derivatives for the purposes of trade reporting (Squawkbox, 20 February, 2014).

Regulators and market participants claim the confusion ultimately stems from the lack of a clear definition under the Markets in Financial Instruments Directive (MiFID).

According to the consultation document, “concerns have been raised about whether the regulation of FX activity is adequate and applied on a consistent basis” and asks for the industry’s views on “where the boundary lies between what is an FX financial instrument and what is not, specifically the definition of a spot FX instrument.”

The lack of clarity resulted in FX forwards being excluded completely from the reporting requirements in the UK and Luxembourg, based on how the MiFID definitions were interpreted by the Financial Conduct Authority (FCA) and Commission de Surveillance du Secteur Financier (CSSF).

Under the EMIR reporting requirements, the exemption is for FX forwards with a settlement date up to seven days and FX forwards that are concluded for commercial purposes.

But according to the EC, the majority of member states do not have a “definition of a forward or delineate a boundary for FX spots in their legislation” and in the minority of cases where they have, the approach adopted has differed.

“As a result this provision is not currently being applied on a harmonised basis across the Union,” the Commission adds.

Some member states have determined cut off periods of up to seven days before classifying a spot contract as a forward, although the majority “adopt a two-day delineation and/or look at standard market practice”.

“In practice, though, the delivery and settlement of a spot transaction does not take place immediately, for technical reasons or as a result of market practice, and normally takes place a number of days thereafter,” the EC adds. “It is therefore necessary to determine how long ‘immediate’ is and at what point a spot becomes a forward.”

The final definition of FX spot contracts by the Commission will not only impact the interpretation of requirements under MiFID, but will also impact the application of other key pieces of EU financial regulation including the European Market Infrastructure Regulation (EMIR), CRD4 and the Market Abuse Regulation (MAR).

“Once a contract is considered a financial instrument for the purposes of [MiFID], then activity in that instrument may give rise to authorisation and other obligations under MiFID,” the paper states.

“Moreover, since the definition of financial instrument in MiFID is used in a wide variety of other legislation, the classification of an FX contract as a financial instrument will bring them within the ambit of this legislation, in particular EMIR and its reporting obligations.”

Stephane Malrait, Chair of ACI’s FX Committee says that the outcome will also have a “potential global impact for ACI members”.

“The impact of this isn’t going to be only in Europe but also for all users who trade with a European entity,” he adds.

In the US, FX forwards and swaps were excluded under Dodd-Frank, leading some market participants to expect EU regulation to follow suit.

The Commission says it is inviting responses until 9 May 2014.

ACI Board of Education to Launch New ACI Diploma Structure

The ACI Board of Education has undertaken an important project to restructure the ACI Diploma and work on this will continue over the next two years.

According to Claudia Segre, Chair of ACI's Board of Education and Andreas Emser, the ACI Director of Education, candidates will need to have passed the ACI Dealing Certificate or the ACI Operations Certificate plus the new ACI Model Code Certificate examination in order to become eligible for the ACI Diploma exam.

Alternatively, candidates who are senior practitioners with at least ten years' work experience in financial markets and have passed the new ACI Model Code Certificate exam will also be eligible for the ACI Diploma exam. In this instance candidates should submit their CV to the Board of Education, which will then decide on eligibility.

In addition to the two mandatory units – Foreign Exchange and Fixed Income and Money Markets – candidates will have to pass an elective unit in order to be awarded the ACI Diploma. The elective units include ALM and Risk Management, Advanced Derivatives, Compliance, Islamic Banking, and Operations. Each unit will be a separate exam of about two hours.

The Board of Education will go live with the first four units – Foreign Exchange, Fixed Income and Money Markets, ALM and Risk Management and Advanced Derivatives – in October 2014. After that it will begin designing the other units.

The Board also plans to develop a new membership framework for ACI Diploma holders. It will set up a recognition scheme for local ACI exams to be equivalent to the ACI Dealing Certificate. It also plans to establish a continuous professional development program to keep candidates up-to-date with the latest market developments.

Over the past year, the Board has been busy updating the ACI examinations as part of its ongoing commitment to education and in August 2013 it launched the new ACI Model Code exam. As noted, the ACI Model Code exam is mandatory for senior practitioners and ACI Operation Certificate holders wishing to sit the ACI Diploma, where they are not ACI Dealing Certificate holders.

Candidates will need to have passed the ACI Dealing Certificate or the ACI Operations Certificate, plus the new ACI Model Code Certificate examination, to become eligible for the ACI Diploma exam
Claudia Segre

CLAUDIA SEGRE

The Model Code is ACI's code of conduct and provides market best practice guidelines and conventions for global financial markets. It is recognised by central banks and financial institutions globally as a market standard. The Model Code exam, which lasts for one hour, is based on the revamped Model Code published in January 2013 and includes the new FX Best Practices Operations.

The exam is designed for market practitioners in FX and money markets and risk and compliance officers.

In August 2013, the Board also launched the updated ACI Dealing Certificate with a new ALM topic basket and a revamped Principles of Risk topic basket. The Model Code topic basket was adapted according to the rewritten Model Code. Now the whole Model Code is being assessed in the ACI Dealing Certificate, Emser says.

With the ACI Operations Certificate, the Board has added the FX Best Practices Operations of the Model Code topic basket.

Exam candidates should also take advantage of the ACI Global Education Centre online (WikiACI), says Emser, as this offers study guides to help them prepare for both the ACI Dealing Certificate and the ACI Operations Certificate.

"We see new registrations for the Global Education Centre from around the world almost every day," says Emser.

In addition, ACI has a forum and community site for candidates to connect with counterparts. They should register at: http://aci.frankfurt-school.de.

Last year the Board of Education saw an uptick in the number of exams taken, from 1317 exams in 2012 to 1860 in 2013.

In other developments, the Board of Education conducted special marketing and sales activities last year in Singapore, Malaysia, Indonesia, India, Israel, Russia and the Gulf Cooperation Council countries.

"In 2014 we will follow up on those countries and will also approach regulators in Hong Kong, Sri Lanka, Bangladesh, Pakistan, Philippines, Thailand, Vietnam and Sub-Saharan countries in order to seek formal recognition for our exams and support the local market," Emser says.

We see new registrations for the Global Education Centre from around the world almost every day
Andreas Emser

ANDREAS EMSER

Attention Turns to Italy 2015

With a successful 53rd World Congress now over, the attention of ACI members now turns to the 54th World Congress, which will be hosted by ASSIOM Forex next year in Milan. Assiom Forex – ACI's Italian national association, plans to merge its Annual General Meeting with the ACI World Congress, thus offering great opportunities for networking and debate for delegates from around the world and allowing them to meet ACI members in Milan, the host city of Expo 2015.

The ACI World Congress 2015 starts Friday, February 5 and ends on Sunday, February 8. The Congress will host the first speech of the year from the Governor of the Bank of Italy, addressed to the financial community, that usually takes place at the Annual Meeting of ASSIOM Forex. The speech explores the various scenarios in domestic and international financial markets for 2015.
ASSIOM Forex was founded in Milan in 2009 by the merging of ASSIOM (the Bond Dealers Association) and ATIC Forex (The Treasurers and FX Dealers Association), but its origins date back to 1957, when the first of the Italian finance associations, ACI Forex Italy, was founded and joined the Association Cambiste International, called Forex Club, the forerunner of ACI – The Financial Markets Association. The Forex Club was the first international body made up of officials from foreign exchange desks throughout the world, created with the aim of facilitatating the circulation of information and the adoption of common procedures and standards.
Assiom Forex nowadays has more than 1,400 Members, representing about 450 financial institutions, and works to promote and support the professional growth of financial dealers through training courses. It also promotes technical expertise and market practices in order to contribute to the development and integrity of the domestic financial markets in both a European and international context. The Association promotes the analysis, study and research into techniques, tools and matters relevant to financial markets. It supports relations with national and international monetary authorities and supervisory bodies as well as with companies managing the markets and other institutions operating in financial markets and it reinforces ties with national, community and international bodies with

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the aim of improving the activities of its own Members.
Thanks to the creation of a single body, market authorities and supervisory bodies have, in ASSIOM Forex, a unique association that is as representative as possible of the Italian financial system with which to discuss and share problematic issues, proposals and matters. Globalised financial markets, even at a local level, need to be able to give global answers to investors and companies that require a knowledgeable and transparent approach from financial institutions ready to make a fundamental contribution to the economic growth of the country. The Association carries out its activities through specific committees and working groups. The aims of the Association are:
To favour the adoption of indices relevant to the markets in which its members operate,
To promote and carry out initiatives aimed at improving the preparation and professional updating of the Associates.
To share, using appropriate methods of communication, information and news relevant to the technical operating context of the markets, including problems relating to regulations and tax law,
To support synergies with similar national and international associations.
Synergy on an international level is created by the automatic recognition of a member of the Association as a pro-active spokesperson in ACI. Indeed ASSIOM Forex is affiliated with ACI – The Financial Markets Association, the international Association for financial dealers, to which 65 countries and more than 12,000 associates belong.
The Italian financial community is currently the nation that has the largest number of members among those represented in ACI International and it is very proactive in that context, through a wide and constant participation in all of the different ACI Working Groups.
Thanks to the representation of all markets sectors, ASSIOM Forex has become the single point of reference for the italian banking and financial system.
ASSIOM Forex played a major role in the development of Project STEP+, a unified European money market. Giuseppe Attanà, President of ASSIOM Forex explains what is behind the STEP+ project.
"We start from the fact that the money market needs to be better stimulated. In order to do this we need a place where the different needs of the market (bid and offer) can be better matched. Our idea, in the case of the money market, is to bring these different interests together on a single electronic platform where borrowers (typically banks) and investors (any kind of funds and insurance firms

typically) can show their interests.
"This is a revolution for a market where transactions are still not always efficient. The process has become necessary after the recent scandals involving interbank rates, beginning with Libor, which was found to be manipulated – a scandal that has resulted in huge fines for many international banking groups," Attanà continues. "And that also involved the European rate, Euribor, calculated daily by the Banking Federation of the European Union. The project designed by us calling for the creation of a single European money market was taken over directly by the European Banking Federation, which has agreed to take the leadership and to facilitate it, together with the European Central Bank.
"The goal is to concentrate volumes of transactions with the aim to give liquidity to the market, and identifying mechanisms of supervision and control that will ensure the reliability of the market. This solution will help to revive the interbank market, because many banks have left the Euribor panel, so restoring credibility and confidence to the market, through a solution that ensures ample liquidity and transparency is vitally important, as is presenting an active role to the European authorities," he adds.
"Given that the initiative has been developed inside the Money Market and Liquidity Working Group of ACI, this is a great opportunity to enhance its image and authoritativeness within markets and institutions," says Attanà. "As far as ASSIOM Forex is concerned, the collaboration with our international association is for us a real added value and a commitment that will drive much of our work. Important and concrete results can be achieved, in a European perspective, through the evolution of the markets, specifically the adoption of legislation and the development of professionalism. The involvement of the authorities will be significantly important as we work to finalise the project in a short time."
ASSIOM Forex is looking forward to hosting the 54th World Congress, Attanà says, "We received ACI International's request to organise the World Congress of 2015, and we gladly agreed. We have engaged in the laborious (from the point of view of organisation) but also rewarding work. 2015 will be the year of Expo (the Universal Exposition) that will be also held in the city of Milan and that can represent a real turning point for our economy. We will work hard during this year in order to properly accommodate the delegations from those countries representing ACI International and the Financial Markets: Welcome to Italy."

Chicago Fed Explores Thorny Issue of High Speed Trading

The Federal Reserve Bank of Chicago has published analysis highlighting a number of the issues facing both regulators and market participants as a result of what it terms "high-speed trading" (HST).

HST includes high frequency trading, automated and algorithmic trading. In the latest Chicago Fed Letter, senior policy advisor, Carol Clark, notes the danger that a runaway algorithm can have as it triggers other algorithms, adding that the myriad technologies that underpin HST means "systems that are robust yet fragile" are created.
Some HST proponents have noted that this type of trading represents a natural evolution of the financial markets, arguing that the HSTs used to simply be the biggest and loudest people on the trading floor. Clark herself acknowledges the argument that this evolution is similar to those that have seen other major industries automated, but points out, "It is difficult to find examples of firms in other industries that were rapidly brought to the brink of bankruptcy due to technological malfunctions like the 40 minutes it took Knight Capital to lose $460 million."
Clark does note that in the example of Knight Capital the market was able to absorb this disruption with minimal impact to the overall market, however she also highlights a recent episode in which Korean brokerage firm HagMag Securities lost money (exceeding its capital) due to erroneously placed automated orders on the Korea Exchange.
"One report indicates KRX had to use cash from an emergency reserve fund set up by the exchange's brokerage firms to cover the loss," Clark writes. "If HanMag files for bankruptcy and doesn't find a buyer, the exchange's brokers will be required to replenish the money used from the fund."
The difference between the two events, Clark argues, is that Knight had customers deemed valuable by its rivals, whereas HagMag did not.
The benefits of HST are acknowledged by Clark, who cites research that has found it can lower costs, reduce volatility and narrow bid-offer spreads to market participants, however she notes that critics of the strategy often argue this research is developed by parties with an interest in, or sponsored by HST. She also notes that some institutional investors prefer the anonymity that electronic trading provides.
Looking at the equity markets, Clark highlights that order flow is critical to a trading venue's profitability, which is why they are willing so sometimes provide HST firms with time, place of informational advantages over other market participants.
The letter outlines the different pricing strategies being adopted by these venues in a bid to counter the increasing trend of trading off-exchange, noting that an estimated 38% of equity trades now take place in broker-dealer internalisers and dark pools.
Finally, Clark claims that, while market manipulation has always been a concern in trading, it may be more difficult to detect such manipulation in the world of HST.
She says, "Electronic markets, which have been lauded for their transparency, actually have an element of opacity because trading firms do not know each other's identity."
That HSTs trade on correlated products across multiple asset classes and trading venues globally is another reason why it is harder to detect them, according to Clark. "Moreover, trading venues may be monitored by different regulators using different technologies, such as the CFTC's Trade Surveillance System (TSS) and the SEC's Market Information Data Analytics System (MIDAS)," she adds.
The letter concludes by posing a number of policy questions, including whether market participants are underpricing the risks of HST, whether they have the real-time control necessary to manage these risks and whether trading venues should evaluate alternative revenue models?
On the regulatory side, Clark questions whether venues and regulators have the tools necessary to effectively monitor market manipulation and if anyone has the authority to implement an international approach to responding to such manipulation.
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