Summary of FXBG recommendations

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FXCG meeting

Frankfurt am Main, 17 October 2014

Mandate

FSB Plenary charged the working group to focus on FX benchmarks

➢ undertake <u>analysis</u> of the FX market structure and incentives that may promote particular types of trading activity around the benchmark fixings

➢ propose possible <u>remedies</u> to address these adverse incentives as well as to examine whether there is a need and scope to improve the construction of the benchmarks themselves

Members

Co-Chairs: Guy Debelle (RBA), Paul Fisher (BoE)

Reserve Bank of Australia
Bank of Canada
Bafin
Banque de France
Bank of Japan & Financial Services Agency
Banco de México
Monetary Authority of Singapore
Swiss National Bank
Bank of England and Financial Conduct Authority
Federal Reserve Bank of New York & Federal Reserve Board
European Central Bank
IOSCO
FSB Secretariat

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Engagement and timeline

Engagement with:

➢ Global and local asset and money managers,

➢ Non-financial corporates

➢ Benchmark providers in FX and other markets

➢ FX trading platforms

➢ Banks and investment banks

Timeline:

14 February 2014: Creation of the Group

15 July 2014: Interim report for public consultation: large number of answers

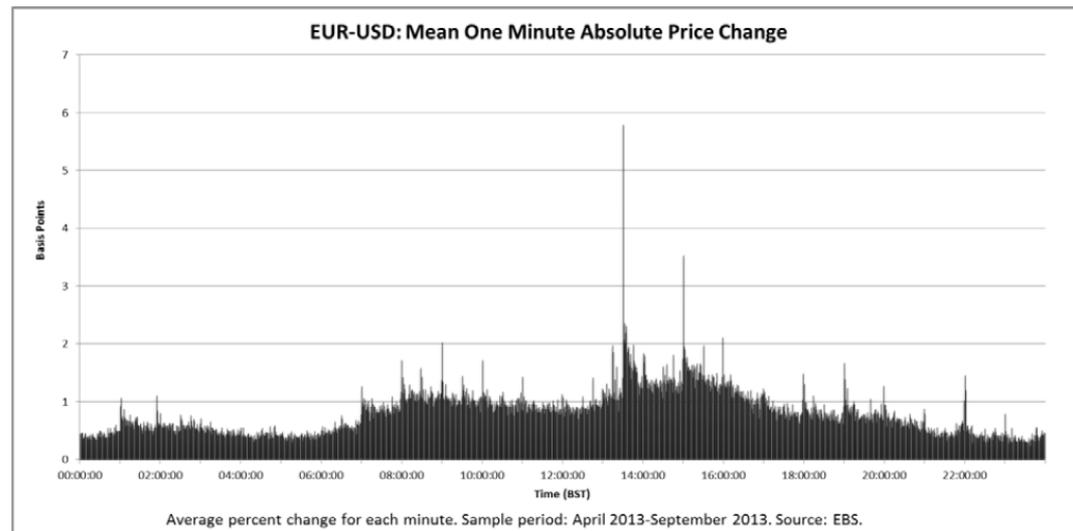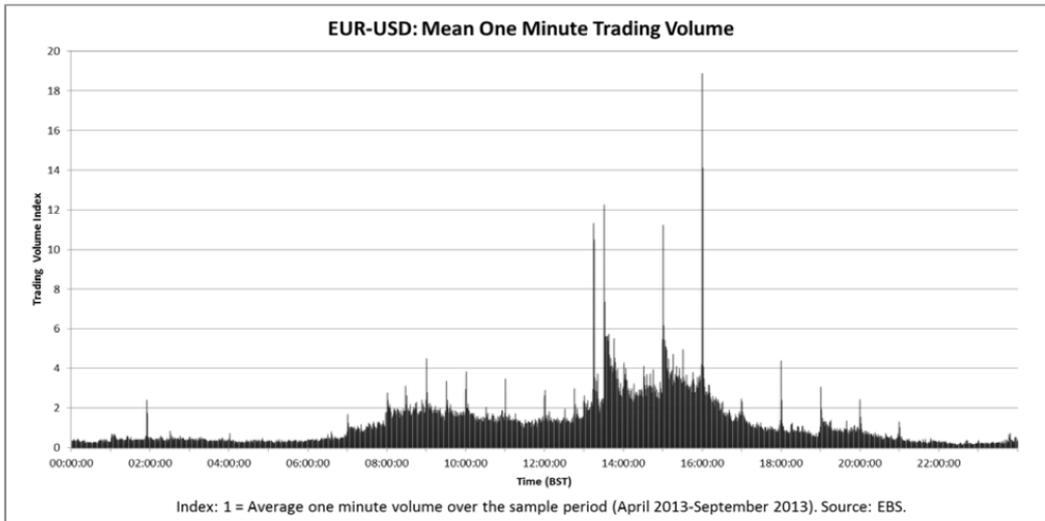30 September 2014: Final report

November: Submission to G20 in Brisbane

WMR Benchmark

- based on actual trades, supported by transactable bids and offers for liquid currencies

- less well traded currencies, active bids and offers are used

➢ issues arising are therefore quite different in nature from those relevant to Libor

➢ data analysis shows large spike in trading volumes, not in volatility

Data analysis: large spike in volumes, not in volatility

EUR-USD: Mean One Minute Trading Volume

Index: 1 = Average one minute volume over the sample period (April 2013-September 2013). Source: EBS.

EUR-USD: Mean One Minute Absolute Price Change

Average percent change for each minute. Sample period: April 2013-September 2013. Source: EBS.

Source: FSB report

FX benchmark usage and implications

- variety of purposes, but most notably for valuing, transferring and rebalancing multi-currency asset portfolios

- guaranteed published fix price, in order to establish transparency of execution

  - ➤ concentration of trading orders

  - ➤ execute orders in the market as principal

  - ➤ dealers hedge by executing foreign exchange transactions in and around the calculation window

  - ➤ dealer agreeing to execute orders at an unknown price

  - ➤ in most cases, the dealer give the client the mid-rate

Implications and risks

➢ "creates optics of dealers 'trading ahead' of the fix *even* where the activity is essentially under instruction from clients."

➢ "Worse, it can create an opportunity and an incentive for dealers to try to influence the exchange rate – allegedly including by collusion or otherwise inappropriate sharing of information"

➢ "opportunity for improper trading behaviour of market participants around the fix, more than the methodology for computing the fix (although the two interact), could lead to potential adverse outcomes for clients"

Summary of recommendations: methodology and market structure

1. Fixing window be widened

2. Incorporate price feeds and transaction data from a broader range of sources

3. WM to include a named user group to consider changes

4. Supports finding of IOSCO review of WM

5. Central banks to take note of the guidance of IOSCO principles

6. Support the development of industry-led initiatives for creating netting facilities

Summary of recommendations: behaviour (banks)

7. Fixing transactions be priced in line with the risk borne

8. Banks establish and enforce internal guidelines and procedures

9. Market makers should not share with each other information about their trading positions

10. Market makers should not pass information to clients that enable to anticipate flows

11. Banks should establish and enforce internal systems and controls

Summary of recommendations: behaviour (others)

14. Index providers should review whether the foreign exchange fixes used in their calculation of indexes are fit for purpose

15. Asset managers should conduct appropriate due diligence around their foreign exchange execution

Issues for discussion

➢ Any feedback and views from members?

Thank you!