



Global Codes of Conduct and the Case for the Mexican Market

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BANCO DE MÉXICO

* The views expressed herein are those of the author and not necessarily represent those of Banco de México's governing board

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Introduction

- After the Global Financial Crisis, there was an urgency to stabilize markets and deal with pressing financial stability issues. Not only did the crisis uncover excessive risk-taking by financial institutions, but also deep cultural and ethical failures.
 - ✓ *Doubts surrounded the ethical standards and transparency norms under which the industry had been operating.*
 - ✓ *In this regard, the trustworthiness in financial institutions was challenged, which is relevant because of the impact on public perception and, very importantly, because of its key relation with market efficiency.*
- With this in mind, we have been working to address the confidence breach with stronger rules both from authorities and from markets themselves.
 - ✓ *For the latter, codes of conduct play a crucial role, because abiding by commonly agreed rules greatly contributes to the integrity of markets and of the information that they produce.*
 - ✓ *This is essential to enable an efficient price discovery and formation process, and ultimately, for greater economic welfare.*

Introduction

- Central banks, together with multilateral institutions, have been strongly committed to helping develop and promoting adherence to codes of conduct on a range of fronts, from benchmark rates to FX markets.
- These codes establish good practices by which market participants should abide in order to promote an ethical, transparent, and robust market.
- Today, the task for market participants, including associations and infrastructure providers, is adapting their practices to make them consistent with codes of conduct.

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International coordination on conduct in FICC markets

- The Financial Stability Board has been coordinating efforts on measures to reduce misconduct risk.

- Role of incentives

- ✓ *Compensation structures*

- ✓ *Governance and culture*

- ✓ *Enforcement powers of banking regulators and supervisors*

- International coordination on conduct in fixed income, currency and commodities (FICC) markets

- ✓ *Financial benchmarks*

- ✓ *Standards of market practices*

- Coordination in the application of conduct regulation

International coordination on conduct in FICC markets

- Market manipulation scandals exhibited deficiencies in behavior standards, which have in part reflected:
 - ✓ *Regulatory regime gaps*
 - ✓ *Challenges of enforcing standards of conduct*
- International coordination by different authorities has been in place to:
 - ✓ *Guarantee that measures to improve conduct are effective*
 - ✓ *Reduce regulatory arbitrage*
 - ✓ *Address other gaps in standards of market conduct*
- A range of actions and recommendations are being taken by different authorities to improve the standards of conduct.

Financial benchmarks

- Interest-rate and FX benchmarks are clear examples in which market conduct standards fell short in recent years.
 - ✓ *IOSCO (International Organization of Securities Commissions) published in July 2013 the Principles for Financial Benchmarks.*
 - ✓ *A set of recommended practices that should be implemented by benchmark administrators and submitters. The IOSCO Principles involve 19 principles that benchmark rates must meet in terms of governance, quality of benchmark, quality of methodology and accountability.*
 - ✓ *IOSCO undertook reviews of major interest-rate benchmarks (LIBOR, EURIBOR, and TIBOR) and key FX benchmarks (WM Reuters 4pm London FIX).^{1/}*
 - ✓ *FSB published reform recommendations for major interest rate benchmarks (July 2014) and for FX benchmarks (September 2014).*
- The main financial centers have implemented or are in the process of implementing some of the recommendations for enhancing existing benchmarks. In the case of Mexico, the Central Bank is in the process of implementing some of these recommendations in the TIIE calculation process, although the determination process was quite sturdy from the beginning.

^{1/} Financial Stability Board progress report on measures to reduce misconduct risk. November 2015

Standards of market practices

- Work to deal with gaps in standards of conduct is in progress in different jurisdictions.
 - ✓ *UK's Fair and Effective Markets Review and Money Markets Committee*
 - ✓ *European Securities Market Authority*
 - ✓ *US Treasury Market Practices Group*
- Many reform initiatives have used the financial industry feedback to shape and implement improvements.
- The most important internationally coordinated effort launched so far has been the one proposed by the BIS Governors in May 2015 to set up a foreign exchange working group under the auspices of the BIS Markets Committee, to strengthen code of conduct standards and principles of foreign exchange markets.

FX Working Group

- The main objectives of this Foreign Exchange Working Group (FXWG) are:
 - ✓ *Facilitate the creation of an FX Global Code that can be adopted by all foreign exchange market participants.*
 - ✓ *Develop mechanisms to promote and incentivize the usage and implementation of the FX Global Code.*
- The group involves officials from 16 central banks around the world and 33 private sector representatives.
 - ✓ *The FXWG also formed a Market Participants Group (MPG) in order to incorporate a wider set of FX market participants in the creation of the Code.*

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FX Global Code

- The FX Global Code is a set of principles of good practice in the foreign exchange market, developed to provide a common set of guidelines to promote the integrity and effective functioning of the wholesale FX market.
 - ✓ *It is intended to promote a robust, fair, liquid, open, and appropriately transparent market.*
 - ✓ *For its elaboration, codes of conduct in several financial jurisdictions were taken into consideration.*
- The FX Global Code is voluntary in nature as it does not impose any regulatory or legal obligations.
 - ✓ *As a principles-based document, firms must be primarily responsible for its implementation.*
 - ✓ *Still, it has been created with the idea of serving as a complement to local regulation and as a global reference document with regards to processes and good practices in the foreign exchange market. In any case, authorities should be able to hold market participants accountable for demonstrating sustained, observable compliance.*
- All market participants are expected to use the FX Global Code in the global foreign exchange market. They include: financial institutions, corporate investors, institutional investors, central banks, electronic trading platforms, and brokers, among others.

FX Global Code

- The final version of the FX Global Code will be published on May 25, 2017.
- Several commitments have already been agreed upon its publication:
 - ✓ *The 16 participating FXWG central banks would adopt the Global Code immediately for their international reserves management operations.*
 - ✓ *The different local FX Committees (FXCs) have committed themselves to adopt such principles.*
 - ✓ *In fact, the FX Global Code will substitute the local codes of conduct in each of the original eight jurisdictions where an FX Committee existed when the FXWG was established.*
 - ✓ *Finally, in such countries where an FXC does not exist, monetary authorities will promote the adoption and adherence to the Code among all market participants.*

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FX Global Code – Bank of Mexico

- Banco de México was an active participant in the process of developing the FX Global Code throughout these past 24 months.
- The Central Bank has also adopted some commitments related to the FX Global Code:
 - ✓ *Banco de México will adhere to the FX Global Code in regards to its international reserves management operations.*
 - ✓ *Additionally, Banco de México will only carry out operations with those institutions that have also adhered to the Code after what is considered the implementation process of between 6 and 12 months after publication.*
- Banco de México will seek to promote the adoption of the Code in local markets.
 - ✓ *Notwithstanding that adherence to the Code will rely on a voluntary basis by market participants, Banco de México will monitor its implementation by financial firms within their corporate organization and will assess its effectiveness.*

Mexican Foreign Exchange Committee

- Moreover, Banco de México will organize a local FX Committee (“Mexican Foreign Exchange Committee”) that would meet frequently to exchange different points of view among market participants and in connection with relevant issues that concern the FX market.
 - ✓ *This setting will also promote the adherence to the FX Global Code in the local market and will represent Mexican interests in the FX markets in multinational forums.*
- The Mexican Foreign Exchange Committee will be sponsored by Banco de México and will be comprised of high profile representatives of the main participating institutions in the local foreign exchange market.
 - ✓ *The Committee will be established during the second half of 2017.*

Money markets and fixed income markets

- Financial authorities should seek to replicate all these measures and recommendations in money market and fixed income markets around the world.
- In fact, there are some committees or groups, either sponsored by central banks or comprised on an independent basis, related to these markets, that already exist in some jurisdictions such as the United States, United Kingdom, Japan, Canada, Euro-zone, Hong Kong, and others.
 - ✓ *In a few cases, a code of conduct or best practices has been made public (e.g. Treasury Market Practices Group (TMPG) sponsored by the Federal Reserve of New York and the Money Markets Committee sponsored by the Bank of England).*
- In the case of Mexico, the Central Bank, in consultation with other authorities, will follow the task of creating a code of conduct during the following months in order to promote it in local fixed income markets.

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Final remarks

- The financial crisis uncovered excessive risk-taking practices by financial institutions, but also deep cultural and ethical failures.
- Recent financial markets scandals have undermined trust in the financial system.
- Sanctions have been acting as deterrents to misconduct, but more emphasis on preventive approaches is needed to mitigate the risk of misconduct.
- The current challenge for market participants, including associations and infrastructure providers, is adapting their practices to make them consistent with codes of conduct, which lay the groundwork for a better culture.



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