

KPMG Chairs of Audit Committee Event

Remarks by Mark Yallop, Chair of FICC Markets Standards Board

Thursday 22nd June 2017 at 20 Grosvenor Street, London W1K 4QJ

Good morning

Thank you for coming along this morning; it is a pleasure to be here with you. I will take the next 10 minutes to address very briefly four basic questions that I think are interesting and then I hope we can have an open and wide ranging question and answer session.

1. What is the FICC Markets Standards Board - or FMSB - and what do we do?
2. What problem are we trying to solve?
3. What will change as a result of our work?
4. How can we help non-executive directors and non-executive directors help us?

What is the FICC Markets Standards Board and what do we do?

FMSB was established as a result of the Fair and Effective Markets Review as a private sector, global Standard setting organisation for the wholesale fixed income, currency and commodities markets.

Our sole purpose is to identify areas where day-to-day practice in wholesale markets is unclear or ambiguous; to develop Standards which guide market participants in simple, practical ways on how to react in those circumstances so that market users get the best and clearest outcomes possible; and to have those Standards adopted as widely as possible across global FICC markets.

We have 50 Members who provide knowledge, funding and commitment from the highest levels of their senior management. About half our Members are banks and half non-banks – including major corporations, asset managers, hedge funds, exchanges, clearing houses, electronic trading platforms, brokers and data providers.

Our Members account for at least 80% of all activity in wholesale FICC markets worldwide.

And they have made available about 200 expert executives to help with identifying where Standards are needed and developing the Standards themselves.

Last year we published 5 Standards; this year we are aiming to publish a further 10. We have identified about 75 topics on which we expect to publish Standards over the next 3 years or so.

There are two points to emphasise I think:

- first, this is self-determination in action: FMSB is the wholesale market taking responsibility itself for fixing the serious problems revealed in recent years, rather than relying on regulators to tell it how to behave;
- second, this is a unique project: never before has anyone tried to bring together all sides of the wholesale markets – market makers and price takers, issuers and investors, banks and corporates and asset managers – to address how markets should work.

Both these factors give FMSB a much better chance of addressing real problems, and changing behavior in markets, than anything tried before.

I should mention two important limitations on our scope:

- we are not addressing retail financial markets or products;
- we are not – at least at present – trying to tackle problems in the equity markets;

And I should also make clear that we are not a lobbying organization (unlike for example, ISDA, ICMA, AFME and others), nor are we an enforcement or self-regulatory body: we have no powers to compel our Members to work with us and we don't audit or inspect our Members' adherence to our Standards.

What problem are we trying to solve?

We are trying to address, at their root, the causes the misconduct problems that have featured repeatedly in wholesale markets over the past 200 years and more.

Right now, the DoJ is investigating manipulation of the US Treasury market. But the earliest efforts to manipulate that market date from 1792 when the then Assistant Secretary to the US Treasury – and it turned out the first of the great insider traders of the modern era - was helped by a group of unscrupulous bankers in an attempt to corner the market. In the 225 years since then there have been numerous well publicised squeezes, cornering, crashes and other problems.

The SEC and the FCA are today looking at abuses of markets by electronic trading engines. But French bond prices traded on the Bordeaux exchange were being manipulated by traders who found a way to interfere with the telegraph system that transmitted prices from the Paris bourse back in 1834. Network abuses are as old as networks and a human is always the weakest link.

I am not arguing that regulation is unnecessary or bad; good regulation *is necessary* for markets to operate credibly and safely. But it is an observable fact that regulation and new laws have not prevented the frequent repetition of market misconduct and abuse. So regulation and the legal framework *is not sufficient* to ensure fair and effective markets.

One of the biggest problems is that regulation tells wholesale markets very little about how to operate. Many wholesale markets are not regulated at all. And in those that are regulated there is a big gap – we call it the regulatory void – between the high-level principles that the FCA and other regulators publish and the detailed rule books.

In this gap, multiple views develop about how participants should treat each other. These do not foster fair or effective markets.

What is needed *as well as regulation* is guidance that tells market participants how to operate in practical ways when they encounter ambiguous circumstances, for example:

- I sold a barrier option to my client. Now the market is approaching the knock-out/knock-in. Can I buy/sell to over/under-hedge my position (and thereby impact the likelihood of the barrier being reached or not)?
- I'm leading a new issue for my client: what should my secondary trading desk be allowed to do to hedge its contingent risk that they will end up owning bonds?
- I'm an issuer: how much control should I have over who my bonds are distributed to? How would I like the reference yield for my deal to be selected?

There is nothing in regulation which tells anyone how to answer these questions, and yet they cause confusion, frustration and sometimes anger every day in markets.

But Standards, developed jointly by market participants who understand how markets actually work, can address these questions.

There has been a view in some places that wholesale markets were places only for adults; that adults could take care of themselves and so a blind eye could be turned to what went on.

But given the systemic nature of misconduct risk today this argument no longer holds water.

What will change as a result of our work?

Over time I hope the impact of our work will be profound and global, not just here in London.

At a simple level I hope that adherence to FMSB Standards will become the norm for the bulk of wholesale FICC markets, alongside compliance with local regulation as is expected today.

I also hope that market participants who are not FMSB members will appreciate the value of FMSB Standards and want to do business using our Standards, spreading the relevance of this work much more widely than just our 50 Members and their clients.

But at a more profound level I hope that this initiative restores the "market discipline" which is missing today.

We need to get back to a position when market practitioners have the means and incentives themselves to police fair and effective markets and the best outcomes for users of markets; and individuals and institutions in positions of knowledge, power and influence in markets use their advantages in a professional way to ensure the best outcomes for users of markets.

I might add that I don't see any conflict between fair markets and commercial returns: in my view fair and effective markets will be more attractive places to do business, trade in higher volumes and be more profitable than markets which are, or are suspected to be, abused.

How can we help non-executive directors and non-executive directors help us?

Which brings me to why we are here today. I think we can help each other in several ways, and of course I would love to hear your views on this as well.

First, several of you are on the Boards of FMSB Member firms. Senior executives at your firms have made commitments actively to use FMSB Standards as they are developed. You may wish to enquire of your executive how this is actually happening in practice and how they make themselves comfortable that they can make such commitments.

I hope you would want to do this anyway, but I think you may also find it helpful when dealing with the FCA in your NED capacity, as I know the FCA will be interested to see how Standards are being embedded in daily life inside businesses.

Second, as you review from time to time the risks in your businesses with your executive you might like to bear in mind the potential for Standards, which clarify expectations on all sides in markets and reduce the risk of buyer's remorse, to play a part in risk management for your businesses.

Third, again as you review business risks and regulatory compliance you may alight on issues which you think could be usefully made the subject of Standards. We have no monopoly on wisdom and are always very interested in ideas for new Standards.

I'm sure that what I have said will have stimulated other ideas as well. So, I thank you for your attention and look forward to continuing the discussion with questions.