Political Economy of Financial Markets Seminar

Rebuilding Trustworthiness in Financial Markets

Remarks by Mark Yallop, Chair of FICC Markets Standards Board

St Anthony's College, Oxford

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Good afternoon

It is a pleasure to be here with you today.

I'm going to spend the next 40 minutes or so talking about the manipulation of wholesale financial markets; why this happens and how big a problem it is; why it is so hard to fix; and some new ideas that we are trialling in the UK which I think offer a radical and much more credible solution to improving outcomes for market users than those that have been attempted so far.

Market manipulation in the time of Napoleon…

Sunset in Dover on Sunday 20th February 1814 fell shortly after twenty past five in the afternoon. The day had been bitterly cold, windy and misty; and the night followed suit. So the physical preparations for drama were all in place when John Marsh, keeper of the Packet Boat Inn in the town, was disturbed later that evening, as he shared a pipe in the bar with his friend Thomas Gourley, by a loud knocking on the door of the Ship Inn, a rival hostelry on the opposite side of the street, and the sound of a voice demanding a post chaise carriage to London.

Dover at this time was on constant alert for news from the Continent. Napoleon had been defeated in his disastrous Russian campaign in 1812, and again at Leipzig in October 1813, but was still at large with significant forces in Northern France. While no-one in England seriously feared an invasion, Napoleon at the head of an army was nonetheless a potent threat. Indeed, Napoleon had thoroughly trounced the Coalition forces led by Blücher on six occasions in battles across Northern France in the previous 3 weeks. So, at this stage, Britain waited news of Napoleon's next move with something like breathless anticipation.

The source of the knocking turned out to be a stranger, dressed in a soaked greatcoat over an unusual-looking, battle scarred and very muddy uniform, who stated that he was Lieutenant-Colonel du Bourg, just arrived from France with the most important news that had to be delivered immediately to Admiral Foley, Commander of the south coast naval forces at nearby Deal.

Had they looked more closely, some of the surprised Dover residents, who had gathered at the disturbance, might have noticed that the battle-stained uniform was in fact streaked with boot-black; and they would have been even more surprised some minutes earlier to have seen the stranger standing in the nearby millstream throwing water over his coat to simulate a sea-soaked Channel crossing.

But unaware of these details, the locals provided Du Bourg with the wherewithal to write to Admiral Foley, and his letter set out the stunning news that Napoleon had been defeated in battle: "Bonaparte was overtaken by a party of Sachen's Cossacks who immediately slayed him and divided his body between them. General Platoff saved Paris from being reduced to ashes…an immediate peace is certain" he wrote.

Du Bourg's letter was delivered to Admiral Foley at 3am, but the poor weather prevented its transmission to London via the primitive telegraph system then available. Nevertheless, the sensational news started to spread by word of mouth, across and inland from the south coast, even at this early hour. And Du Bourg left for London personally, changing horses and carriage several times before arriving in the capital early on Monday 21st.

While Du Bourg was *en route*, two gentlemen claiming to be French officers of the pre-Napoleonic Bourbon government appeared in Dartford, with even more lurid details of the demise of the Emperor, also demanding transport to the capital.

The combined effect of the overnight rumours and the arrival in the early morning of two separate parties with news of impending peace created pandemonium among Londoners and on the Stock Exchange. Large crowds gathered outside the Mansion House hoping for an official announcement from the Lord Mayor. In the course of the day government stocks – gilts – rose in value by an astonishing 20 per cent.

Inevitably, as the day wore on with no further corroboration of this dramatic turn of events, suspicion mounted and disappointment grew. It was confirmed later in the afternoon that Napoleon was in fact alive and that Lieutenant-General Baron Sachen's Cossacks had been engaged elsewhere. Gilt prices fell sharply and many investors caught up in the frenzy of the morning lost large sums of money.

In the investigation that followed it transpired that only four individuals had sold gilts on that Monday – Sir Thomas Cochrane (10th Earl of Dundonald, a distinguished Naval hero, MP and member of the Order of the Bath), Andrew Cochrane Johnstone (ex-

Governor of Dominica, MP for a rotten borough in Cornwall and Thomas's uncle), Richard Butt (a stockbroker) and John Holloway (a wine merchant).

These four owned almost £1m in holdings of gilts – equivalent to £50m million today - at the start of the day's trading. They could have made profits of between £5 and £10m in today's money on their trading, if things had gone well; as it was they only netted about £0.5m – this was long before the days of best execution rules!

The four of them, and du Bourg, whose real name turned out to be Charles Random de Beringer, were tried at the Old Bailey on eight counts including that they:

"…did conspire and by diverse false and subtle arts, devices, contrivances, representations, reports, and rumours to occasion without just and true cause a rise and increase in the prices of the public Government Funds … and sell and cause to be sold for them divers other large parts of the said Government Funds at higher and greater prices than said parts would otherwise sell for with a wicked and fraudulent intention to thereby cheat and defraud … all his Majesty's subjects who should contract for or purchase part of the said public Government Funds … of diverse large sums of money…"

They were found guilty, fined, placed in the public pillory at the front of the Royal Exchange and sent to prison for 12 months in the first ever successful prosecution in the English courts for market manipulation.

… and a more recent example

Almost exactly 200 years later an unfortunate individual called Tom Hayes found himself in the dock at Southwark Crown Court charged with 8 counts of conspiracy to defraud by manipulating Yen LIBOR over the period 2006-2010.

Hayes' interest in Yen LIBOR arose from his position as an interest rate derivatives trader in Tokyo during this time, first at UBS and then at Citigroup. The derivatives he was trading typically involved exchanging fixed interest rate payments in Yen for floating interest rate payments, also in Yen, in contracts known as interest rate swaps and forward rate agreements, on substantial underlying notional amounts – typically many tens or hundreds of millions, and not infrequently billions, of dollars equivalent.

Corporate borrowers in Yen who prefer to fix the (otherwise variable) cost of their bank debt, and institutional investors who want to fix the yield that they earn on floating rate Yen investments use these instruments to achieve this. Banks typically stand in the middle between such borrowers and investors, facilitating an efficient market between parties with naturally opposite economic interests, and taking trading positions as well, based on their view on markets. As a result these banks have substantial portfolios, or "books", of fixed and floating Yen interest rate risk.

The floating payments for these swaps and rate agreements are calculated by reference to the London Interbank Offered Rate – or LIBOR – which is set each day at 11.00am London time as an average of the rates provided by a panel of reference banks.

The protocol for the reference banks at the time was for them to submit to a calculation agent, without comparing notes with each other, the rates at which they were able to borrow in the relevant currency, in this case Yen, for a series of monthly tenors up to one year. The agent then dropped the highest and lowest submissions received, averaged the middle ones and published the result. It was believed by most observers that discarding the high and low outliers in this way meant that the truncated average LIBOR calculated was free from any distortions.

Each day Hayes, and all other traders in the Yen market, would have dozens, or often hundreds, of swaps and forward agreements for which the floating leg needed to be determined, in this fashion. The total amounts of such swaps being set – or "fixed" – by reference to LIBOR would be in aggregate for each trader many hundreds of millions, and generally billions, of dollars equivalent.

Some simple maths will tell you that a one-hundredth of 1% move – 1 basis point - in LIBOR will change the value of a 1 billion position fixing for 6 months by 50,000. With 250 fixing days each year, a favourable move of just 1 basis point each day on a 1 billion portfolio would generate 12.5m of profit each year. You can easily see how, with a larger portfolio and LIBOR moves greater than just 1 basis point, the profits that could accrue to a trader over a year might be many tens, or even hundreds of millions.

At some point before 2006, Hayes realised that the borrowing rates being supplied by the reference banks for LIBOR didn't actually represent real rates for borrowing in the market, but rather were guesstimates of where individuals working at those banks thought they might be able to borrow. Those individuals, and their guesstimates, were susceptible to suggestion and could - and would - change as traders, and the brokers who did business between them, shared opinions about conditions in the interbank market.

Over the next few years, he used this insight to his advantage: cajoling and threatening his brokers and other individuals at reference banks to move their LIBOR submissions in the direction that suited his book day by day.

Just as de Beringer planned to use a new technology – the semaphore telegraph – to assist in his fraud, so Hayes used new technology – Instant Messaging – to assist his. Unfortunately for him, this technology also saved his messages, and this proved his downfall.

He was recorded explaining to another trader that he was:

"*…mates with the cash desks,* [at another bank] *and I always help each other out" so that "3m Libor is too high cause I have kept it artificially high..."*

He used brokers to assist in coordinating his efforts to manipulate LIBOR and their messages didn't help either - as one of Hayes' brokers wrote to him:

"…if you drop your 6m dramatically on the 11th mate it will look v. fishy especially if [Bank X] *and* [Bank Y] *go with you. I'd be v. careful how you ply it, there might be cause for a drop as you cross in to the new month but a couple of weeks in might get people questioning you..."*

… to which Hayes replied: *"don't worry will stagger the drops…"*

Relationships played their part – but so did money. Hayes was recorded telling one broker that he would give him a significant trade if he would assist in Hayes' manipulative plan:

"If you keep 6s [i.e. the six month Yen Libor] *unchanged today… I will f*****g do one humongous deal with you…. like a 50,000 buck deal, whatever. I need you to keep it as low as possible… if you do that… I'll pay you, you know, 50,000 dollars, 100,000 dollars… whatever you want… I'm a man of my word."*

It was subsequently revealed that Hayes had transacted 45,000 Yen trades; that his profits varied by up to $2.5 million for each 1 basis point that he could move LIBOR (corresponding to an underlying position of between $50 and $100 billion!); and that he had been aiming to move LIBOR by up to 15 basis points on some days.

Hayes was sentenced to 14 years' imprisonment at Southwark Crown Court on 3rd August 2015; and his appeal against this sentence was refused in December the same year.

I relate these two stories for a couple of reasons.

First, because they bookend a detailed historical review that we have undertaken of every market abuse case that has reached the English law courts over the past two centuries. The manipulation of British government bond prices that de Beringer and his collaborators engaged in during the later stages of the Napoleonic War, and the manipulation of LIBOR that Tom Hayes and his collaborators engaged in two centuries later, are respectively the first ever and the most recent cases of market manipulation tried by the English courts.

But second, these stories are important because they illustrate uncomfortable truths about market abuse and conduct problems in wholesale markets.

- Two centuries of human evolution have not changed human nature or the propensity of people to succumb to financial temptation and manipulate markets.

- Two centuries of financial evolution have not changed the way markets operate in very fundamental ways, although technological developments have facilitated the job of the manipulators and made the role of the authorities much harder.

- Two centuries of legal efforts and regulatory evolution designed to address market manipulation and deter or bring manipulators to justice have manifestly failed to achieve their desired result.

Disguise was fundamental to the frauds perpetrated by both de Beringer and Hayes. In the early 19th Century, dressing up as army officers enabled a group of cunning individuals to disguise a massive manipulation of market prices. Two hundred years later, technology – in the form of instant messaging and social media – and a poorly specified algorithm – the protocol for calculating LIBOR – provided the disguise. But the fraud behind the disguise - manipulation of market prices by a group of collaborators - was almost identical.

Of course, it hasn't always been a group of cunning rascals who were in disguise.

In 1987, in the Chicago futures markets, the exchange authorities were concerned about corruption in the trading pits, including pre-arranged trading, fictitious trades, out of hours trades and the use of "bagmen" (locals who would do favours for brokers and traders in exchange for cash payments). As these were floor based, open outcry, markets at that time, a normal external investigation was not possible. So the authorities placed agents on the floors of the Chicago Mercantile Exchange and the Chicago Board of Trade, disguised and working as traders, and wired for sound. Ironically, one of the enforcement agents – "Randy" Jackson - actually turned out to be a half-decent broker. What they observed and recorded resulted in 46 indictments for various trading abuses over the two years that followed.

This tale has an amusing codicil.

The following year, one Thompson Saunders, a former grains trader on the CBOT and a group of collaborators, wore wigs, eye shadow, glasses and fake trading identities, badges and trading jackets to gain access to the CBOT financials trading floors and conduct fictitious trades in Treasury Bond futures. One of the defendants in the trial that ensued explained to the court the difficulty he had had in finding the right shade of mascara to paint in his false moustache. In his defence Mr Saunders claimed that he had been inspired to engage in covert trading by the actions of the authorities in the CME the year before, and to hide his trading activity from over-zealous lawyers representing his former wife…

Technology and financial product innovation has multiplied the opportunities for misconduct in markets many times over – and has levelled the incidence of misconduct across markets; but the fundamental root causes of misconduct, and the reasons for its repeated recurrence, have not changed much over two centuries.

Why do Conduct problems keep recurring?

So why have conduct problems kept recurring in markets?

I'm not talking here of occasional "bad apples". De Beringer's and Hayes's will crop up in every generation. The scale of financial markets will create continuing temptation for those bent on crime. Some individuals will be tempted, and some of these will get caught. But isolated examples of weaknesses of the flesh and the doctrine of original sin are for theologians.

The more interesting questions are whether financial markets are, or perhaps have become over time, systemically prone to abuse and how markets operated by humans who are in the main upright, law abiding citizens, have magnified the effects of malevolent actors to produce the disastrous outcomes we have seen over the past decade.

There are at least three big problems with the way capital markets have come to operate. The first is the nature of relationships in markets businesses. The second is the problem of collective action by market players. And the third is how markets are regulated.

First, the <u>nature of relationships</u> in markets.

Markets activity has been at the core of investment banking, and their predecessor merchant banking businesses, for two and a half centuries. In the earliest days, these firms were often commodity traders, who moved successively into the financing of those commodities and on into the underwriting, issuing and trading of purely financial instruments.

Conflicts of interest have always been inherent in the evolving business of these firms and they had to be managed effectively. Individual firms, and people within those firms, came to possess privileged information; and they had to develop ways to manage the conflicts of interest that came with this knowledge.

They did this in the way they organised themselves - generally as partnerships - through their recruitment methods, and in the way they developed their business models, concentrating on advisory businesses where relationships were highly valued. Capital was committed only when necessary and then fleetingly. Reputation, the maintenance of trust between firm and client, and ensuring good outcomes for those clients, was not only a necessity: it was a key source of competitive advantage for these firms.

But the development of widely traded capital markets, and the technological and economic modelling advances that supported the growth of derivatives from the 1970s onwards, made the investment banking business more commoditised, more reliant on formal legal relationships and fundamentally changed the nature of trusting relationships in the industry and with its clients.

When more financial capital is at stake - and it is committed for much longer periods (as it is over many decades in derivatives transactions today) - through trading, capital market and derivatives activity, and technology has eroded information advantages, then the inevitable trend is for business to be ruled by black letter law and formal contracts, not by reputation and standards.

There is another aspect to this evolution as well: economic advances and technological change also enabled individuals to build personal reputations in the industry as important as those of the firms they worked for. This has increased significantly the potential for conflict between the interests of the firm and its star employees, not just between the firm and its clients. The fact that these conflicts have often been resolved in favour of the employees, not the employers, has also served to emphasise the role of formal contractual arrangements between firms.

But this reliance on formal contractual arrangements has had unfortunate, unintended consequences.

Courts must apply the law precisely, which in practice means narrowly; and market participants of course anticipate this. A “narrow” application of the law in turn creates incentives for legal arbitrage, as participants develop ways to achieve their economic goals in a form that doesn’t infringe the law – often thereby creating an unintended consequence for the lawmaker.

This kind of legal arbitrage has been widespread for my entire career, and I daresay for many years before that. I’m not suggesting that legal arbitrage is an offence; but the mind-set that it encourages converges in the extreme limit to a view that “if it’s not illegal we can do it”.

Formal law is always open to interpretation; and those who look for clever interpretations and creative loopholes will always find them. But when the first and most important question is "how do I avoid breaking the law" then regard for others, and discussion of the fairness and effectiveness of their outcomes, get crowded out. This is a high price for lawmakers, and society, to pay.

Second, the problem of collective action.

I believe that many in wholesale markets have been aware (even if dimly) of at least some of the opportunities for bad outcomes in markets long before the manipulation of benchmarks and other problems were revealed in recent years; although I'm sure that few of them envisaged the scale of what, for example, Tom Hayes was able to achieve, which was met with genuine astonishment as the details emerged.

But those individuals were caught in a bind: an extreme form of collective action problem in which the short-term rewards, personal and corporate, were so great, and the discount factors on longer term rewards were so punitive, that collaboration with others to change the system was never, or hardly ever, a viable strategy.

The way in which remuneration structures operated, and career paths were managed, also exacerbated already strong incentives to preserve the *status quo*.

But the result was that markets lacked any mechanism to unlock this collective action problem and provide a solution to the dilemma that kept market participants economic prisoners of their situation.

Third, the way in which conduct regulation has evolved.

There are two broad approaches to regulation for financial markets: principles-based and rules-based.

Both these camps struggle to address the causes of conduct failure.

On the one hand, the high level "principles" approach does not guide specific market practice or provide guidance at a granular enough level to show market participants what is acceptable behaviour in real life situations.

But neither on the other hand does the multiplicity of low-level, complex operational rules that the "rule book" approach takes show market participants how to transact or how to behave.

There is a “void” between high level principles and low level rules which needs to be filled with better guidance for market participants if Conduct problems are really to be fixed.

The FCA rule book is a two-metre-high stack of A4 paper, but only about 1cm of this pile provides guidance on how to transact business. The rest focusses on a multitude of operational and reporting requirements.

Nowhere do these rules address the myriad challenges that FICC market users face, day to day, in the live market place, for example:

- how should a syndicate desk act in managing the allocation process for a new bond deal fairly, taking into account the separate views of the issuer, investor and lead manager? What information might the desk share with potential investors about the state of the book ahead of pricing?

- how might this advice change if the deal is being co-led by several banks acting together?

- how should a trader who has sold a barrier option hedge his position as the market approaches the barrier level?

- what actually is the difference between legitimate hedging of barrier risk and market manipulation?

- what safeguards should a firm executing a reference price transaction have so as not to disadvantage its customer?

- how should bidders and those managing bids on behalf of others in a government bond auction act so that demand is accurately portrayed to investors?

- in what sequence should bids and offers reaching an electronic central order book be executed? First in first out? Largest orders first? On a randomized basis? How should work-up orders be treated in an electronic market? Is the proliferation of order types across multiple electronic trading platforms a good idea or not?

- how should circuit breakers operate in algorithmic trading machines? Should there be a limit on flash orders?

- how should voice and electronic markets operate alongside each other?

The fundamental point is this: when traders or salespeople need advice on how to do business they can't be told "make sure you treat your customer fairly" or "make sure you act with due skill, care and diligence". These are important – vital – principles: but what he or she needs at that moment is clear, well-articulated guidance that speaks to their specific market and situation, and this cannot be found in regulation, at least as regulation is conceived today.

The absence of such guidance, and existence of the "conduct void", leads to a second problem which we have labelled "conduct anxiety". When institutions and individuals come to fear that their actions today may be reinterpreted in future by a conduct regulator with 20/20 hindsight then they often conclude that it is just more prudent not to trade today. It hard to prove forensically, but there is plenty of anecdotal evidence that the reductions in trading activity, and in market liquidity over the past 8 years, have significantly exceeded what was intended in the regulatory clamp-down after the 2008 crisis, and which would be expected as a logical result of the tougher prudential capital and liquidity rules.

Given the crucial transmission role of FICC markets in global economic growth this is not a good outcome either.

Does all this really matter: why not just accept higher costs?

Proponents of reform and sceptics of global capitalism often suspect that the arguments I just laid out are special pleading. They argue that we must accept the higher costs imposed by regulation as an inevitable cost of doing business in a world let down by human frailty.

I have to say I find this a defeatist view.

The fines imposed, and the cost of the remediation work that went with them – which is not just financial - are not only a problem for the short-term profits of a few banks.

They are hindering the recapitalisation of the banking system, and contributing to a long-term "investability" problem for banks. And they are throwing grit in the wheels of global wholesale markets, reducing trading volumes and increasing the cost of trading, which is a problem for us all: investors and infrastructure providers, corporations and individuals, just as much as banks and high frequency market makers, and for economic growth and society at large.

The industry has paid away, or provided for, conduct fines and costs of $375 billion in the past 5 years. Eighty per cent of this - or $300 billion - was driven by wholesale market activity.

Alongside the gigantic fines for US mortgage mis-selling, the $10 billion in fines for each of the FX and LIBOR problems seem almost insignificant. But these FX fines wiped out a whole year's revenues – or probably 2-3 entire years of net profits – for the entire global spot FX industry. Put another way, the fines were equivalent to 5 continuous years of 15% annual, compound, margin compression in the industry.

And then there are the huge, multi-billion-dollar remediation and on-going infrastructure and control costs.

The Bank of England recently estimated that if those conduct fines had instead been retained as capital, they would have supported more than $5 trillion in lending to the real economy.

But the financial impact of the crisis and its clean-up is only one side of the coin. The crisis also destroyed trust – within the industry, between financial services and the users of markets, and between financial services and society.

All the efforts, which have been underway for 8 years now (and have a long way further to go), to rebuild capital and liquidity levels in the financial system and increase its resilience to crisis, will not of themselves restore trust in markets. They may be a necessary, but they are certainly not a sufficient, condition for re-establishing trust.

And without a restoration of trust, within financial services and between financial services and the users of those services, the transmission mechanisms that markets provide for global economic growth will remain fractured.

And the improved stability that financial reform has brought may be the stability of the graveyard.

Thousands of hours of debate and tens of thousands of words have been devoted over the past 8 years to the question of how trust in financial services might be restored.

So I hesitate to stray into this realm of philosophy today, particularly with so many of you more expert in it than I am. But it seems to me that the answer is not so difficult for wholesale markets, at least in principle, and lies in re-thinking the concepts of responsibility, accountability and trustworthiness.

Onora O' Neill, one of our most eminent philosophers, said a couple of years ago that the question is not "how do we restore trust" but rather "how do we make it easier to judge trustworthiness".

If market participants can do two things, then I believe Baroness O'Neill's challenge can be answered.

First, wholesale market participants need to take responsibility themselves for leading the process of fixing problems that have been uncovered - and particularly for demonstrating better outcomes for market users. Of course, to do this they have to be permitted this opportunity by their regulators, and to act in a credible framework.

Second, those wholesale market participants need to find credible, granular ways to define what will be done differently in future. These changes need to be genuine, and the evidence of change needs to engage judgement, not merely the ticking of boxes, in order to demonstrate accountability. And the evidence need to be published, so that others can judge whether change is real and actually demonstrates trustworthiness.

This is precisely what we are attempting with the FICC Markets Standards Board, FMSB, which I will talk about in a minute.

Why should Standards help in addressing the problems described?

But before talking about the FMSB, let me say a couple of words about Standards, as any mention of deploying Standards in a heavily regulated industry always raises eyebrows.

Why should Standards help in addressing the difficulties I have described?

There are at least two good reasons.

First, because Standards don't suffer the "unintended consequences" problem of formal law by creating incentives to arbitrage the rules. Standards determined by market practitioners eliminate this risk *a priori*.

Second, because Standards reinforce the concept of professionalism – which itself needs to be enhanced, not undermined, in financial services.

Participants in wholesale financial markets have highly asymmetric knowledge; some are considerably better informed about what is going on than others. How this knowledge is acquired by the well-informed, and maintained and acted on, defines the professionalism of those market participants.

The professional acquires duties and obligations to others as a result of the power bestowed on him or her by this greater knowledge - an obligation, that is, to act responsibly and with due care for the interests of others who are less knowledgeable. The one matches the other. If power and knowledge are not balanced then trust between buyer and seller, principal and agent, adviser and client - the essence of professionalism - is lost.

Standards provide the guardrails that individuals need to safeguard the use of professional knowledge, and the power that that knowledge creates.

I think there is also a third reason for the financial services industry to embrace Standards, at a time when many firms are struggling to make acceptable returns: and this is because they should improve efficiency.

Laws and regulation are (generally) set nationally and have to operate within a defined jurisdiction. Individual countries, politicians and regulators inevitably have differing priorities. Anyone working in a global or international institution who has to wrestle with an inconsistent patchwork of regulation and legal frameworks across the world in order to do business knows this.

By contrast, wholesale financial markets – especially those for fixed income, currencies and commodities – are global and many of the firms working in them are organized and operate globally. It is much easier, and significantly more efficient, for Standards to be developed and adopted internationally, to address the global nature of wholesale markets, than nationally-determined laws and regulation.

Much of regulation is by definition only distantly concerned with efficiency.

Standards by contrast, sitting alongside the legal and regulatory apparatus, are naturally well-placed to promote efficiency.

If you are familiar with the history of the British Standards Board – founded in London at the beginning of the last century – you may know that its first act was to agree a reduction in the number of London tram gauges from 75 to 5, thereby increasing the interoperability of tram networks, shortening the lead time for producing new rails, reducing costs for tram companies and increasing the markets for tram rail manufacturers.

If Standards could do something equivalent today for wholesale financial markets that would be a very welcome secondary benefit.

What is the FMSB and how can it help?

In this country, a bold initiative was established a year ago to give wholesale market participants the responsibility for fixing conduct problems of the sort we have talked about and improve the outcomes for market users; and thereby to give those participants the opportunity to rebuild trust in wholesale markets.

This initiative is the FICC Markets Standards Board, or FMSB, which I Chair.

FMSB was established by the UK authorities to identify the fundamental causes of failure in global wholesale FICC markets, bring together representative users from all sides of the markets to agree solutions, publish them as Standards, and provide a "trustworthiness gauge" for others' to judge the effectiveness of those Standards.

It gives market participants real responsibility to define Standards that will fill the regulatory void and combat the "conduct anxiety" problem.

We are practitioner-led, and practical; owned and operated by the major participants in wholesale markets, for the wholesale market. We are independent of regulators but complement their work.

We have a membership of 40 institutions, most of them global, representing all sides of the wholesale markets: sell side - UK and international commercial and investment banks; buy side - real money asset managers and hedge funds; corporations; exchanges and OTC trading venues; custodians and other market infrastructure providers.

Our members account for more than 80% of all sell-side activity in wholesale markets, over $10 trillion in assets under management, over $100 trillion in custody and administration assets, over $100 billion in corporate new issue volumes in the past year, 45% of global inter-dealer broker volumes and a very large share of exchange traded volumes.

We have the enthusiastic and active support of the UK authorities – the Bank of England, HM Treasury and the Financial Conduct Authority - in particular from Mark Carney and Minouche Shafik. And we are building relationships and support from other Standards Boards and overseas authorities.

Our Board is made up of the most senior people in our industry: Chief Executives and Chairmen, Investment Bank CEOs and Global Business Heads. This is not a talking shop.

We have already published several Standards and other guidance on Conduct in markets covering topics as wide-ranging as the trading of barrier options, surveillance of FICC markets, the Eurobond new issue process and training of FICC professionals at member firms. All our members have committed to using these Standards in their businesses.

But there is of course much more to do. We have an ambitious programme over the next 3 years to:

- extend our membership;
- accelerate the production of further Standards that cover all contentious areas of wholesale market practice;
- promote international adoption of the Standards where they are relevant in other wholesale market centres; and
- assist our members and the markets more widely with the adoption of our Standards.

We have reviewed the horizon of conduct problems. Sandwiched in the 200 years between de Beringer and Tom Hayes there are 240 other cases of market abuse that have reached the English courts. We have analysed each of these and found about 30 underlying common root causes of conduct failure, all still relevant today - and relevant across geographical boundaries to other jurisdictions.

We have gathered our membership's views on current conduct problems, some of which are new – particularly those related to the adoption of technology in markets.

In all, we believe that there are about 70 issues that need to be addressed by FICC Standards or guidelines.

These range from big, broad strategic questions which affect all markets such as the electronic market making questions I raised earlier; or the definition of the role of agents vs. principals in markets; or the dissemination of "market colour" information – to highly specific questions such as how government bond auctions should be conducted, or the right to a "last look" exercised by a market maker in foreign exchange.

Naturally, many of these questions have at their heart the management of conflict of interest between the two or more parties to a trade. But not all of them.

We have developed a prioritisation algorithm to decide in what order to tackle these questions; and we hope to have addressed a significant number of them in the next 24 months.

The Standards we publish are short, written in plain English, and based on principles to make it easy to extend them to practical situations. We accompany them with worked examples to make the point even clearer.

At the end of each year we require all Members to provide a short and comprehensible public adherence statement setting how they will adhere to the standards published in the previous 12 months.

In this way, I believe we can meet Baroness O'Neill's test: "have we made it easy to establish trustworthiness?". And from this in due course, trust itself will flow.

We are not a policing organization, but we will report publicly each year on the rate of adoption of FMSB Standards so it will be transparent how far adoption by our Members has progressed and how the "void" is being filled.

Market forces will play an important role in fostering adoption of Standards by other market users – as Central Banks, asset managers and corporations demand to transact according to the new Standards. But I think some regulators will also be pushing for adoption; in the UK the FCA has stated that it will use FMSB Standards in its implementation of the new Senior Managers Regime. Overseas we will work with local authorities to promote the adoption of FMSB Standards that are tuned to local market needs and regulation; and several jurisdictions have already asked us to work with them.

One of the reasons the FMSB has been successful thus far is that we are focused: we are not preaching about culture; we are not engaging in any industry lobbying; we are not concerned with any aspect of financial services or markets outside the wholesale world of FICC. We are not seeking to replace regulation or interpose ourselves between firms and their regulators.

We are writing Standards for markets globally, not just in the UK. We will work with and share ideas and Standards with any other body that is willing to do so. In due course, I would like to see FMSB Standards adopted worldwide wherever they can help to illuminate best practice and fair and efficient markets, resting alongside and complementing local rules and regulation, and fostering confidence and high standards of trading among all market participants, fulfilling the ambitious expectations originally placed in them by the Bank of England and others.

Three things are fundamentally different about the FMSB from anything that has been tried before: it is a private sector body empowered by the authorities to take charge of improving user outcomes; it includes members from all sides of the industry; and it has a clear adherence mechanism.

These three facts give the FMSB a chance to succeed where previous initiatives have failed to get traction. And for these reasons, I am very confident we will be successful.

Indeed, if there was a bit more of this, we might have much less regulation. But we shouldn't kid ourselves that regulators will just stand by if we fail to do a proper job: if credible, and effective, Standards are not developed, and soon, then regulators will fill the void in their own way.

So the stakes are very high.

It will be a tragedy if the real lessons of a $5 trillion shock are not learnt and our wholesale businesses fail to build the stronger foundations that global markets need; but an equally big tragedy if the wrong lessons are learnt, the regulatory void is filled with ever-more prescriptive formal regulation, and the wheels of global fixed income markets grind ever more slowly.

Ladies and Gentlemen, thank you for your attention.