FICC MARKETS STANDARDS BOARD

Secondary Market Trading Error Compensation Standard

for the Fixed Income, Currencies and Commodities Markets

January 2019

Final

I Introduction

1. The FICC Markets Standards Board

The FICC Markets Standards Board ("FMSB") was established in 2015 in response to the Fair and Effective Markets Review in the UK with a mandate to issue Standards designed to improve conduct and raise standards in the wholesale Fixed Income, Currencies and Commodities ("FICC") markets. The FMSB will work to build up a body of Standards over time, prioritising those areas where its Members consider there is a lack of clarity in the standards of behaviour expected of market participants, or a lack of understanding of the issues relevant to a product or transaction type, or evidence of poor conduct.

2. Applicability of FMSB Standards

Each FMSB Member firm is expected to confirm annually that it is committed to conduct its FICC market activities (its "Activities") in a manner consistent with the Core Principles contained in FMSB Standards, and to have internal policies, procedures and controls reasonably designed to give effect to those Core Principles where they are applicable to its Activities, in a manner that is commensurate with the nature of its Activities in the relevant entity or jurisdiction. That confirmation is expected to apply to all FMSB Standards issued in final form in the calendar year prior to the year in which the confirmation is made. The details of FMSB Member firms are available at www.fmsb.com. Standards will be shared with non-Member firms and their associations, who are encouraged to consider them and conduct their FICC market activities in a manner consistent with them. Information on Standards will be made available to users of the wholesale FICC markets (e.g. corporates and end investors) so that they may be made aware of their existence and FMSB expectation of market conduct.

3. Relationship with law and regulation

FMSB Standards do not impose legal or regulatory obligations on FMSB Members, nor do they take the place of regulation. In the event of any inconsistency, applicable law, rules and regulation will prevail. In developing Standards, relevant regulators will in many cases have commented on their drafting, alongside FMSB Member firms and other bodies, such that the Standards once finalized and published are intended to represent an authoritative statement of global good practices and processes.

4. Relationship with other codes

Other codes already exist in relation to certain FICC markets (notably from ICMA, AFME and the Investment Association). There will be some overlap between the work of the FMSB and some other bodies and the FMSB will seek to ensure it adopts a consistent approach in cases of overlap wherever possible and will seek to avoid issuing a Standard where the subject matter is already covered adequately by existing regulation or a code issued by another body. It may, however, draw attention to Members of an existing Code and request adoption, once appropriate steps have been taken to confirm its applicability.

5. Transparency Draft Standards

The FMSB plans to issue "Transparency Drafts" of its proposed Standards in order to enable all FMSB Members and other interested parties to comment on the proposed Standard. The normal period for comment will be indicated on the date of publication of the Transparency Draft.

II Secondary Market Trading Error Compensation Standard

1. Explanation

This Standard sets out expected behaviours that are designed to improve the practice regarding the payment of compensation for trading errors.

These expected behaviours are designed to enhance transparency in relation to the making of payments of compensation for trading errors and to reduce the risk that such payments create a false or misleading impression in the market or create conflicts of interest.

2. Scope and applicability

This Standard applies to all participants in the wholesale secondary FICC markets in Europe (but subject to any applicable local regulatory restrictions). However, it is anticipated that it will be adopted by market participants in other jurisdictions over time.

This Standard is intended to apply in respect of the payment of compensation agreed between the parties arising out of a trading error.

III Arrangements for Secondary Market Trading Error Compensation

1. Background and Statement of Problem

Parties to a transaction may agree, for commercial or regulatory reasons, that compensation is appropriate where trading errors arise due to the action or inaction of one of the parties to a transaction[1] that cause an economic disadvantage to one or more of the other parties. Trading errors can occur for many reasons including, but not limited to, miscommunication and timing issues. This Standard does not address the circumstances in which a compensable trading error might arise, how the risks of such circumstances might be mitigated, the reasons why a party may compensate another party, or the desirability or magnitude of compensation. These are fact and circumstance dependant matters between the parties, which may also be governed by applicable local regulation, and are beyond the scope of this Standard.

This Standard deals only with procedures for effecting payment, identifying some that that are appropriate and some that are not.

[1] For the purposes of this Standard, a party to a transaction shall include an inter-dealer broker, electronic trading platform or other intermediary which acts as principal, an agent, or arranger/order passer in relation to the transaction.

2. Compensation for Errors

Core Principle 1: In the event that it is agreed between the relevant parties that compensation is to be paid for a trading error, it should be paid in one or more of the following ways where permitted by applicable law and regulation[2] and in accordance with the party's internal policies and procedures:

1. By direct payment to the compensated party's/parties' account nominated by the compensated party's/parties' Operations Department or control function, or

2. By reduction or increase in net brokerage[3] until the agreed level of compensation is reached, or it is agreed between the parties that the compensation should cease, or

3. By another means which does not create a false market in, or a misleading impression as to the value or liquidity of, any relevant financial instrument, or create a risk that the compensation is paid to a party other than the entity incurring the loss.

The method of compensation to be used should be agreed between the relevant parties, and transparency may be improved by agreeing a "default" method reflected in the terms of business between these parties. Parties should consider in advance of doing business their default method of compensation. However, the parties shall not be limited to this default method and may agree on a case by case basis (for example, due to the product traded not been originally envisaged in the terms of business, or otherwise) that another method should be used.

Where a trade or trades have been erroneously booked, for example by the inclusion of a price or other parameter that was not as agreed with the client, the relevant details may be amended, subject to complying with applicable law and regulation, or any applicable requirements of a venue on which the transaction was executed. That may have the effect of "compensating" the client, but in substance is simply putting the client in the position they would have been had the trade been recorded correctly. Any such change in the terms of a "booked" trade should only be to amend genuine booking errors, must not change the substantive terms agreed between the parties, and must be undertaken in compliance with applicable law, regulation and Venue rule (if relevant). Where the error is discovered after the day of booking, it should be amended "as of" the original trade date.

[2] Local regulation varies considerably with regard to permitted payment mechanisms. Market users should exercise care and familiarise themselves with local rules, in particular in relation to conflicts of interest and inducements. Market users should also exercise care to properly document compensation payments and reasons in circumstances where there may be less transparency than other mechanisms would facilitate.

[3] This method will only be appropriate where the parties have an ongoing, regular trading relationship. Care should be exercised where the parties trade infrequently, as this method could give rise to an incentive to trade with the compensating party where none would otherwise exist. Where payment of compensation is achieved by a reduction in net brokerage, this should be designed to be achieved as soon as reasonably

Other methods of compensation including, but not limited to, those effected by way of wash trades[4], off market priced trades[5] or other transfers of financial instruments should not be used. Although it is accepted that the intention of such practices in these circumstances may not be to manipulate the market, they should not be used as the impact may be to suggest a false market level or volume to other market participants. Compensation payments should be clearly identifiable as such.

3. Policies and Procedures

Core Principle 2: Firms should have policies and procedures in place relating to the handling of compensation payments subject to this Standard. Such policies and procedures shall also detail the internal steps which should be undertaken where a payment of compensation is to be made.

Firms should set out clearly in their policies or procedures when other departments should be involved in the process of making a compensation payment, for example, whether another department needs to be involved prior to a compensation payment being made.

Firms may determine to use materiality thresholds in determining the procedures applicable to the making of compensation payments, and such procedures should be proportionate to the quantum of compensation in question. To the extent that firms apply such materiality thresholds, these should be appropriately reviewed from time to time.

Firms should also include clear provisions on record-keeping with respect to compensation payments and potential compensation payments. All compensation payments should be appropriately captured and recorded in accordance with the firm's policies.

Where the amount of a potential compensation payment is very small, such as where transaction costs may exceed the amount of compensation to be paid, the parties may agree that the payment shall be waived. In such cases, appropriate care should be taken to document the reasoning for the non-payment.

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practicable. As noted elsewhere in this Standard the method of compensation should be agreed by both parties.

[4] A wash trade, for the purpose of this Standard, is one where a purchase and sale of the same financial instrument occurs in order to effect the payment of compensation. Such transactions may, for example, create a misleading impression in the market of volume and price on at least one of the legs of the trade in the market.

[5] An off market priced trade, for the purpose of this Standard, is one executed at a price other than that prevailing in the market at the relevant time for the given quantity of a financial instrument, the price difference being designed to effect the payment of compensation from one party to another. Such a transaction can, for example, create a false impression of both volume and price in the market.