

Meeting Minutes

Federal Reserve Bank of New York

33 Liberty Street

13th Floor

Thursday, November 7, 2019

8:30 a.m. – 10:00 a.m.

Members present: Syed Riaz Ali (by phone), Sarah Ashkenazi, James Brown, Maria Douvas-Orme, Chinedu Ezetah, Terence Filewych, Jill Hurwitz, Glade Jacobsen, Robert Klein, Matthew Lillvis, Nancy Rigby (by phone), Jeffrey Saxon, Lisa Shemie, David Trapani, Frank Weigand (by phone), James Wallin, and Bryan Woodard

Federal Reserve Bank of New York (“New York Fed”) participants: Michael Nelson, Thomas Noone, Sanja Peros, Katherine Ramirez, Geza Sardi, and Shawei Wang

Other participants: Amelia Kaufman (Deutsche Bank, by phone), Jeffrey Lillien (Wells Fargo, by phone), Justin McCormack (State Street, by phone), and David Newns (State Street, by phone)

Argentina

Glade Jacobsen continued a discussion from the previous FMLG meeting about the declaration of an exchange rate divergence by five members of the Emerging Markets Traders Association (“EMTA”) on September 23, 2019. Under EMTA’s non-deliverable forward (“NDF”) contract template for Argentina, the notices of these five members triggered a suspension of settlement valuation for up to 30 days. The same members continued to submit notices of an exchange rate divergence through November 4, but not thereafter.

Since the last FMLG meeting, EMTA held discussions about revisions to its Argentina NDF template, which resulted in removing the provision for an exchange rate divergence going forward. In addition, EMTA shortened the postponement period for a price source disruption from 30 days to 14 days. (Similar provisions in EMTA’s Brazil template are not affected.) EMTA has encouraged members to use the revised template for new agreements. EMTA has

also proposed amending existing contracts via protocol, with the aim of settling contracts as if an exchange rate divergence had not occurred.

Members observed that, once the postponement period for an exchange rate divergence expired, market participants continued to use the “on-shore” rate published by Mercado Electronic Abierto as the standard settlement rate instead of the so-called “Blue Chip Swap Rate.” The “Blue Chip Swap” is an implied rate based on the sale of assets purchased in Argentina in pesos (typically sovereign bonds or stock) and sold in the United States for dollars. The difference in the published prices of the same asset on exchanges in Argentina and the United States determines the swap quote. Members debated whether an implied rate based on asset sales, even though widely-cited, was appropriate for settling foreign exchange transactions. Members also noted the lack of criteria for comparing exchange rates in EMTA’s standard template.

In addition, members discussed the difficulties in creating fallback alternatives to a calculation agent; the possibility of greater divergence between “on-shore” and other exchange rates in response to political and market developments; the risks to prime brokers, customers, and executing dealers from inconsistent exchange rates; and the possible consequences of the European Union’s benchmark regulation, which is scheduled to take effect at the end of 2021.

IOSCO review of suitability requirements

James Wallin summarized a final report by the International Organization of Securities Commission (“IOSCO”) on its review of suitability requirements for complex financial products. The report was based, in part, on responses to a questionnaire that IOSCO promulgated in 2018 to assess the implementation of a set of principles first published in 2013. The principles aim to prevent the misselling of complex financial products.

IOSCO’s final report concluded that the strength of suitability requirements generally correlated to the maturity and depth of the market. Most participating jurisdictions had implemented suitability requirements through legal or policy measures, but the requirements were, in general, not tailored specifically to complex products or the category of market participant. For example, only seven jurisdictions were rated “fully consistent” with a principle recommending that financial institutions distinguish between retail and non-retail customers when distributing complex financial products. China, Hong Kong, Japan, and Singapore received “fully consistent” ratings for each of the nine principles. The United States was “fully consistent” with all principles except for a principle regarding incentive policies.

In addition, IOSCO's report observed that the definition of complex financial product differed across jurisdictions. Members discussed the challenges that this and other differences create for market participants operating across borders.

ESMA market abuse regulation

FMLG Treasurer Jill Hurwitz and Lisa Shemie led a discussion of a recent consultation paper by the European Securities and Markets Authority ("ESMA"). The paper requests public feedback on a number of issues, including whether foreign exchange spot transactions ("spot FX") should be covered by the European Union's Market Abuse Regulation ("MAR")—Regulation 596/2014 of the European Parliament and of the Council.

ESMA's paper presented the pros and cons of extending MAR to spot FX. Among the reasons favoring an extension of MAR, the consultation paper noted the lack of a comprehensive enforcement regime to deter abusive behavior and the connections between the spot FX market and markets for other financial instruments. On the other hand, the FX Global Code is a comprehensive approach to raising standards of conduct in the global wholesale FX market. ESMA's paper suggested that it may be prudent to wait for evidence of the Code's effectiveness before amending MAR. Public comments are due on November 29, 2019.

Members discussed, among other issues, whether a regulation designed to cover exchange transactions is suitable to cover transactions in an "over-the-counter" market—another of the "cons" identified in ESMA's consultation paper. There was further discussion of the relationship between the FX Global Code and local regulation. Some members argued that the uniform principles in the Code could be weakened if local regulation becomes more fragmented. Others argued that the Code's principles were designed to co-exist with local regulation, which already differs among jurisdictions—for example, between FX swap and spot markets. Members also discussed the types of evidence that regulators would find persuasive of the Code's effectiveness, and the possibility that the proposed extension of MAR will lead market participants to decrease trading spot FX within Europe.

N.B. On November 15, 2019, the FMLG held a follow-up call with Victoria Cumings and Fiona Willis from the Global Financial Markets Association to discuss these issues further.

GFXC update

Shawei Wang briefed the members on the agenda for the December 2019 meeting of the Global Foreign Exchange Committee ("GFXC"). The focus of the meeting will be the three-year review of the FX Global Code. The GFXC plans to discuss, among other topics, buy-side engagement, anonymous trading, algorithmic trading, disclosures, and transaction costs.

Members discussed the merits of publishing a set of frequently asked questions, case studies of the application of the Code, a buy-side specific version of the Code or its statement of commitment, the merits of revisiting certain controversial principles, the costs of renewing statements of commitment, and the pros and cons of providing additional examples.

Members also discussed the need for a clear definition of “last look.” Citing recent press reports, members thought there was a misunderstanding among reporters and some market participants. “Last look” could, for example, be confused with “hold times.” In addition, “last look” relates to quotes, but communications often apply the term to orders or executed transactions. There was a consensus that an amendment to Principle 17 of the FX Global Code was not necessary. Instead, a clarification could be contained in a supplementary statement, public letter, or white paper. Members also discussed other terms and concepts that could be clarified, including “order” and principal/agent distinctions. FMLG Chair Michael Nelson requested that members continue this discussion at the next meeting.

Trade reject codes

Continuing a discussion from the October 2019 FMLG meeting, Bryan Woodard introduced two colleagues from State Street, Justin McCormack and David Newns, who discussed their attempts to provide additional trade data through Currenex, an electronic trading platform offered by State Street. In their experience, market participants showed little demand for including trade reject codes in reject messages. Members discussed whether a market-driven set of standard codes would prompt demand and encourage price-makers to provide more information, and whether a catch-all category (*e.g.*, “other”) would diminish efforts at transparency. Members agreed to continue discussions with other platforms, raising questions about demand and operational efficacy.

Digital fiat currencies

Robert Klein summarized a recent speech by Karen Petrou of Federal Financial Analytics entitled “Disintermediation, Disintegration, and Innovation: The Future of Finance Controlled by Big Tech and Giant Central Banks.” Ms. Petrou’s remarks summarized reactions by the international central banking community to Facebook’s announcement of its Libra, and the choices challenges that central bank digital currencies would have to address and overcome. One key issue was who had access to central bank services and liquidity, and what these choices would mean for the transmission of monetary policy. Members discussed related legal questions, including the consequences for bank intermediation and the settlement of transactions.

LIBOR in FXC master agreements

Maria Douvas updated members on discussions with the International Swaps and Derivatives Association (“ISDA”) to include FXC-sponsored master agreements in its protocol for interbank offered rate (“IBOR”) fallbacks. Those agreements are the International Currency Options Master Agreement (1997), the International Foreign Exchange Master Agreement (1997), the Foreign Exchange and Options Master Agreement (1997), and the International Foreign Exchange and Currency Option Master Agreement (2005). Members discussed precedents for prior ISDA protocols that did not require local agreements to adopt of ISDA’s standard definition as a prerequisite to adoption of the protocol. Mr. Nelson requested that members continue to discuss the issue at the next FMLG meeting.

Education and Industry Forum case studies

FMLG Secretary Thomas Noone reported on the work of another of the FRBNY’s sponsored groups, the Education and Industry Forum on Financial Services Culture (“EIF”). That group brings together business school academics with industry representatives to discuss the role that education can play in raising standards of conduct in financial services. In 2020, the EIF plans to publish a series of case studies that highlight ethical dilemmas facing junior employees at financial services firms.

Administrative matters

Ms. Hurwitz gave a brief update on the group’s finances.

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