SPEECH

The FX Global Code: Progress Made and The Path Ahead

October 17, 2023

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Remarks at FX Markets USA, New York City
As prepared for delivery

Introduction

Good morning. It is a pleasure to speak with you today at FX Markets USA. I appreciate the opportunity to be here and engage with so many thought leaders across the foreign exchange (FX) industry.

This year marks half a century since the advent of flexible exchange rates. Over that time, the FX market has evolved considerably. FX traders of the 1970s would hardly recognize the market landscape today, as trading practices have become more complex, market participants have become more diverse, and electronification has transformed the way the market functions.

From my vantage point as a central banker, the FX Global Code is one of the most significant advancements for the FX market in recent years. As you know, the Code is a set of global principles of good practice designed to promote the integrity and effective functioning of the wholesale FX market for all participants.

My remarks will focus on how the FX Global Code contributes to a more efficient, fairer, and more transparent FX market, as well as ongoing work between central banks and the industry to ensure the Code remains fit for purpose as the market evolves. I'll then conclude by highlighting key issues that bear watching.

Before I begin, I would like to note that the views I express today are my own and do not necessarily reflect the views of the Federal Reserve Bank of New York or the Federal Reserve System.[1]

Development of the Code

Supporting a well-functioning and efficient FX market has been a long-standing priority at the New York Fed. In 1978, the New York Fed established the Foreign Exchange Committee, an industry group we sponsor that is dedicated to developing best practices in the FX market.[2]

Nearly a decade ago, central banks called upon the industry to strengthen the integrity of the FX market, which is largely self-regulated.[3] To this end, under the auspices of the Bank for International Settlements (BIS) Markets Committee, the FX Working Group was convened to help facilitate the establishment of global best practices, which culminated in the publication of the FX Global Code in 2017.[4] At that same time, the Global Foreign Exchange Committee (GFXC) was launched to bring together central banks and industry representatives to promote good practice in the marketplace and to keep the Code fit for purpose.[5]

The FX market plays a pivotal role in facilitating the flow of capital in support of international trade and investment. Because the FX market is a public good, its integrity is critical to maintaining the public's trust in the financial system. To promote a robust, fair, liquid, open, and appropriately transparent FX market, the Code lays out 55 principles of good practice. For those principles to remain relevant to current market practices, active engagement with a diverse range of market participants is essential. And since Code adherence is voluntary, the public and private sectors must work together closely to encourage widespread take-up. Many financial institutions and other market participants have adopted the Code's principles as part of their internal processes and procedures. This ensures that the Code becomes embedded in the marketplace and has an enduring impact on trading practices.

Milestones in Code Adoption

In the six years since it was established, the Code has expanded its reach across the FX industry. Over 1,000 market participants from around the world have now signed on to the Code. Whereas the initial adopters were bank dealers, platforms, and technology providers, we have seen greater adoption by the asset management community more recently. Among the top 15 U.S. asset management firms by size, 11 firms, representing about $36 trillion of assets under management, now adhere to the Code. While there is still more work to do to encourage even broader adherence in the market, we believe this represents significant progress.

The Code is clearly having a meaningful impact on trading practices. Many trading venues have reduced the maximum length of their "last look window," a significant number of large bank dealers have announced an end to additional hold times, and several electronic trading platforms now offer trading venues from which non-Code-compliant liquidity providers are excluded. These achievements demonstrate that the Code's principles-based approach can have a meaningful impact on the behavior of market participants.

The Code's influence is set to increase further as we expand engagement with the industry on Code adoption and awareness. For example, the Chartered Financial Analyst program will reference the Code in its Level 1 reading materials, and a GFXC working group has been engaging with rating agencies to explore the possibility of recognizing the Code within their Environmental, Social, and Governance criteria. Developments like these are helping to increase the Code's visibility and promote a broader appreciation of its benefits.

As the Code's influence continues to grow, the GFXC has made strides to ensure that all parts of the FX industry have a voice in shaping the Code's development. We recognize that every market participant, regardless of its size and complexity, has an interest in contributing to a fair and effective market. While the Code is intended for all FX market participants, the relevance of the principles can differ, and it can be challenging to identify which parts of the Code are most applicable to specific business lines. To address this, the GFXC recently introduced the FX Code Proportionality Self-Assessment Tool.[6] Through a series of questions, the tool can help market participants identify which of the Code's 55 principles are most relevant to them. This should simplify the adherence process, particularly for participants with a smaller, less complex profile in the FX market.

The Code Embarks on a New Chapter

While the last several years have brought major achievements, more work is necessary to ensure the Code remains relevant and effective for the market as a whole. The GFXC continues to engage with the industry to ensure that the Code is a living document that evolves in step with changes in the market. To this end, the GFXC leads a regular review and update of the Code.

The most recent Code review in 2021 included enhancements to existing principles and guidance papers that provide clarity on some specific practices. The GFXC also developed Disclosure Cover Sheets to provide greater transparency to market participants so they can better understand how their counterparties implement the Code's principles. These cover sheets have provided greater clarity and visibility into a firm's approach to practices such as "last look" and pre-hedging, which in turn help liquidity consumers make more informed decisions about which counterparties to trade with and how the trade should be executed. The Disclosures Cover Sheets can also be used to inform discussions with counterparties to help market participants better understand their approach to implementing best practices. While there is still more to be done to provide greater clarity around Code practices, this work represents an important initial step.

With the next review about to begin in early 2024, the GFXC is seeking to expand industry engagement further to ensure the Code reflects the diversity of FX market participants, represents different types of institutions, and remains fit for purpose. As such, the GFXC distributed a survey, which closes tomorrow, seeking feedback on the Code's effectiveness, the impact of the previous review, and priority issues in this upcoming review period. The survey provides an important opportunity for market participants to make their voices heard and continue to shape the Code in a way that reflects diverse viewpoints.

The Path Ahead

Looking ahead, an important GFXC priority is FX settlement risk. Given the size of the FX market, the implications of one party failing to deliver to another can be significant and systemic. To better address this risk, the Continuous Linked Settlement Group—known as CLS—was established just over 20 years ago by the private sector in cooperation with central banks.[7] As you know, CLS is now active in 18 major currencies, has more than 35,000 indirect participants, and settles more than $6.5 trillion in payments each day on average. However, because many FX transactions are not settled through CLS or do not involve alternative settlement risk mitigation measures—such as netting and "on us" settlement—there is still a substantial share of payments that are not covered.

The GFXC sought to address these issues in its last Code review by strengthening principles for managing FX settlement risk and gathering industry input to help identify ways to better monitor or reduce principal risk. The GFXC also determined that more frequent collection of FX settlement data through semi-annual surveys distributed by regional FX committees can shed light on industry progress in reducing these exposures. To this end, to ensure that supervisory or policy decisions are made on the basis of sound data, the GFXC launched a working group led by the Bank of England to enhance the current FX settlement data collection template.

FX settlement risk is particularly topical now as U.S. securities are set to move to T+1 settlement, which I see will be discussed in depth later this morning.[8] While this regulatory change is aimed at securities, it has important implications for the FX market. The shortened settlement window means that market participants will need to more closely coordinate the timing of settlement for securities and associated FX trades. This transition will require significant preparation in the FX market given time zone differences, mismatched operating hours, and the diversity of existing settlement and confirmation processes, many of which rely on manual procedures.

As we prepare for a world where the time window for U.S. security settlement is halved, FX market participants will need to carefully analyze their operational and liquidity management practices to avoid disrupting market functioning. Stakeholders may also need to make substantial improvements to their existing operational systems and reconfigure FX settlement processes. An additional consideration is how T+1 will affect the values and volumes that currently settle through payment-versus-payment arrangements.

The Federal Reserve and other central banks have a long-standing interest in reducing FX settlement risk by encouraging the use of payment-versus-payment mechanisms to settle FX transactions, such as those provided by CLS. While CLS can support this change and settle FX trades on a T+1 and to some extent a same-day basis, there could be an increase in bilateral settlement outside of CLS and a reintroduction of settlement risk if market participants are unable to adapt internal processes to meet the condensed deadlines set by nostros that support settlement in CLS. As leaders in the FX industry, it is imperative that you make sure your firms are prepared to manage this industry change well in advance of the May 28, 2024 compliance date. While this regulatory change is still seven months away, I strongly encourage you to begin reviewing and updating your operations and settlement processes now to avoid potential difficulties later.

Conclusion

To conclude, the evolution of the FX market in the 50 years since the advent of flexible exchange rates has been truly astounding. Given the importance of the FX market to the global economy, the official sector will continue to work with the industry to promote a robust, fair, liquid, open, and appropriately transparent market that benefits all participants as well as the broader public. Much of this work will occur through the evolution of the FX Global Code.

At the same time, the job of expanding the Code's reach is not done. I expect our discussions and deliberations during the upcoming review to be illuminating and productive, as it is an important opportunity for market participants to make their voices heard and continue to shape the Code. I hope you will all join us as we bring the FX Global Code into its next chapter.

Thank you for your time and continued active engagement.

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[1] I would like to thank Patrick Douglass for his assistance preparing these remarks and colleagues in the Federal Reserve System for valuable comments and suggestions.

[2] The Foreign Exchange Committee (FXC)

[3] For a more detailed history of the development of the FX Global Code, see Simon Potter, Trends in Foreign Exchange Markets and the Challenges Ahead and Simon Potter, The Foreign Exchange Global Code: Lessons Learned and Next Steps.

[4] The BIS FX Working Group

[5] The Global Foreign Exchange Committee (GFXC)

[6] GFXC, FX Code Proportionality Self-Assessment Tool

[7] The Federal Reserve Bank of New York played a leading role in the development of CLS. *See* Christine M. Cumming, Remarks at the Celebration of the 10th Anniversary of CLS, April 17, 2013.

[8] SEC, Final rule: Shortening the Securities Transaction Settlement Cycle